

P.E.  
12/31/06  
AR/S



07051698

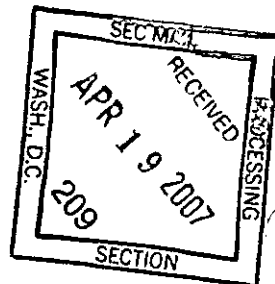
0-31525

# CONFIDENTIAL

## CONFIDENTIAL



American River Bankshares  
2006 Annual Report



PROCESSED

APR 30 2007

THOMSON  
FINANCIAL

# TABLE OF CONTENTS

Our People	2
Who We Are	4
Niches That Differentiate	6
Community Involvement	8
American River Bankshares Foundation	10
Letter from the Chairman and CEO	12
Key Facts	13
Financial Highlights	14
Our Team	16
Financial Table of Contents	17



# CONSISTENCY BUILDS VALUE

92 consecutive profitable quarters

Five-year shareholder return of 206.44%

Stock splits in 1999 and 2003

5% stock dividends from 1997-2002 and 2004-2006

Cash dividends since 1992; quarterly since 1Q 2004

272,000 shares repurchased totaling \$7.0 million in 2006

## **Annual Report Copies**

American River Bankshares will provide its security holders and interested parties, without charge, a copy of its 2006 Annual Report on Form 10-K, including the financial statements and schedules thereto, as filed with the Securities and Exchange Commission. To request a copy by mail, please contact American River Bankshares.

# OUR PEOPLE

## Experience Matters... Leadership Counts

When we say Consistency Builds Value, we aren't just talking about our consistent business philosophy or profitability record – 92 consecutive profitable quarters and counting.

We're talking about the people who made it all possible. The employees of American River Bankshares are the best in the business – their dedication to excellence creates a style of relationship banking that is unmatched in our industry. Our people are the keys to our success.

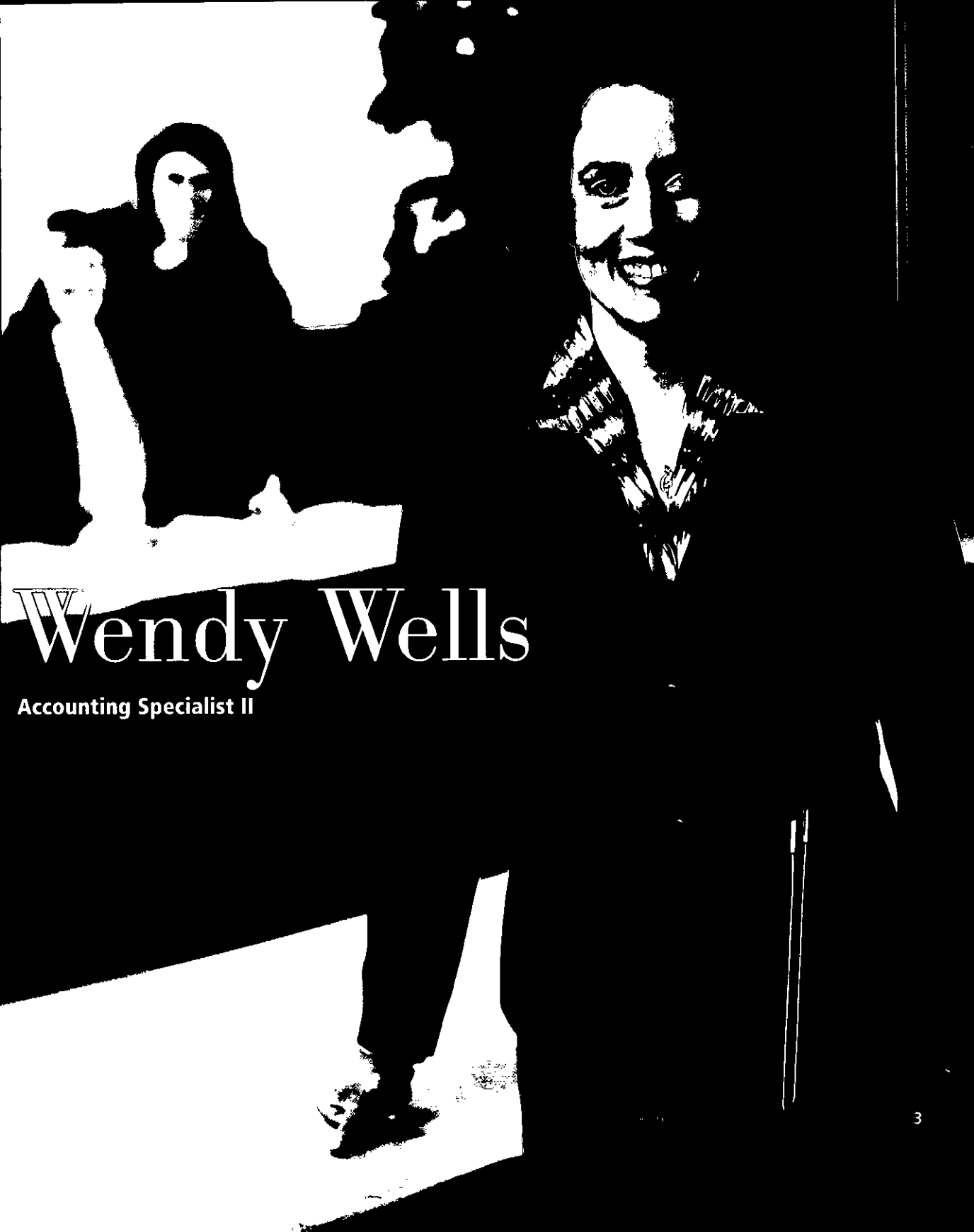
## Our Numbers

**89%** Employee Satisfaction Rating

**7** Average Years of Employee Tenure

**26** Average Years of Industry Experience for the Executive Management Team

**Wendy can drive a tractor**  
She has a commitment to  
excellent client service  
that makes the difference  
when working on  
Company initiatives.



# W Wendy Wells

Accounting Specialist II

# WHO WE ARE

## Specializing in Success for our Clients

American River Bankshares is a financial services company dedicated to maximizing long-term shareholder value by delivering exceptional service, maintaining superior asset quality, staying at the forefront of technology and focusing on organic growth and profitability.

## Our Numbers

**\$20,000** Average non-interest checking account

**\$22,000** Average interest checking

**\$93,000** Average money market account

## **Christina can beat you at Wii**

She is the first to  
volunteer to get her  
hands dirty when it  
comes to supporting  
employees, clients and  
the community.



# Christina LaChapelle

Senior Credit Analyst

# NICHES THAT DIFFERENTIATE

## A Focus on Relationship Banking

Our goal is to become the dominant business bank in the communities we serve by providing our clients exceptional service and financial solutions that support their growth.

## Core Competencies

Commercial Real Estate

Business Banking

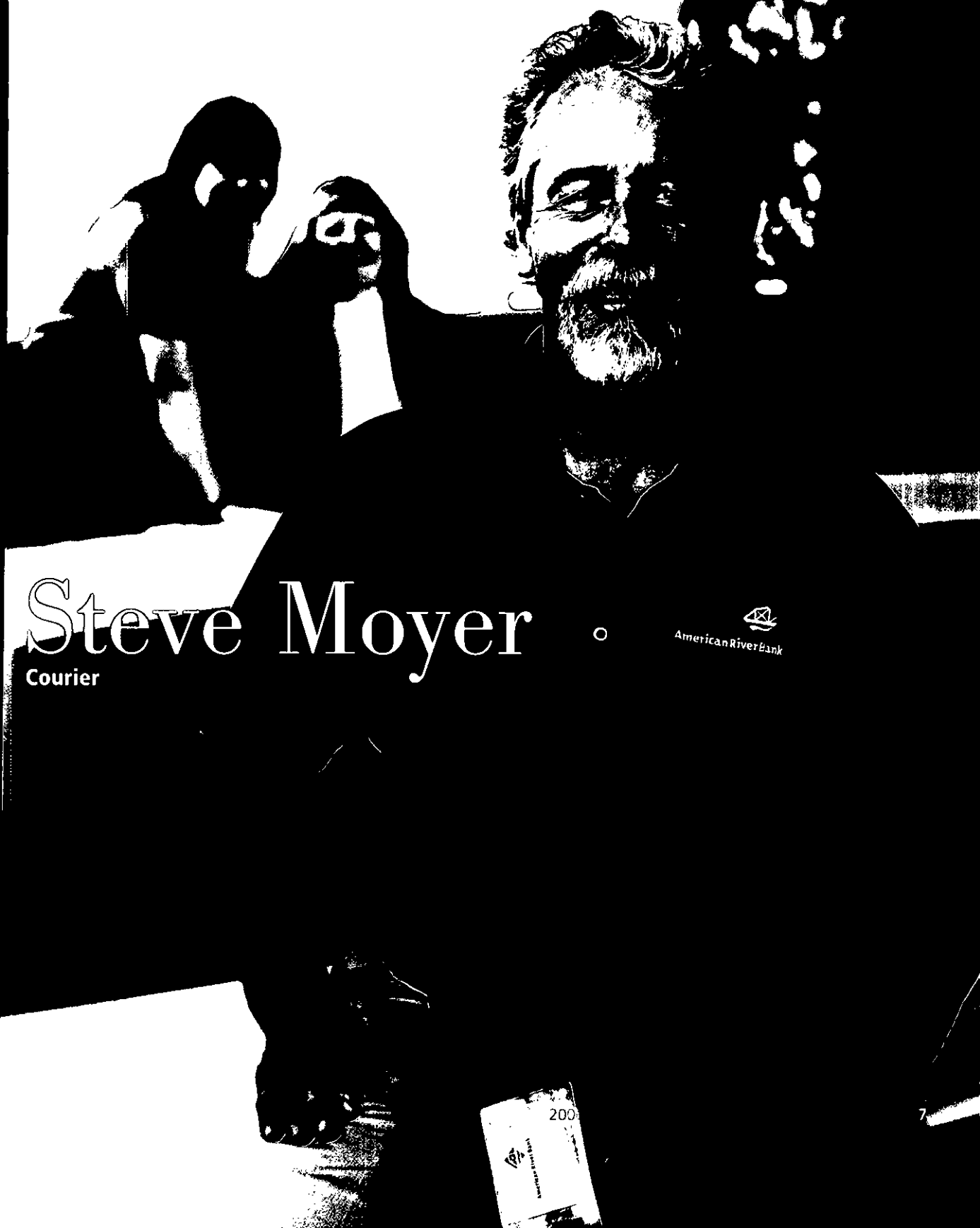
Building Trades

Faith-Based Organizations

Residential Construction

**Steve commutes  
to work on his bicycle**  
He has become  
synonymous with service,  
convenience and fun for  
our courier clients.





# Steve Moyer

Courier

# COMMUNITY INVOLVEMENT

## Helping our Communities Reach their Full Potential

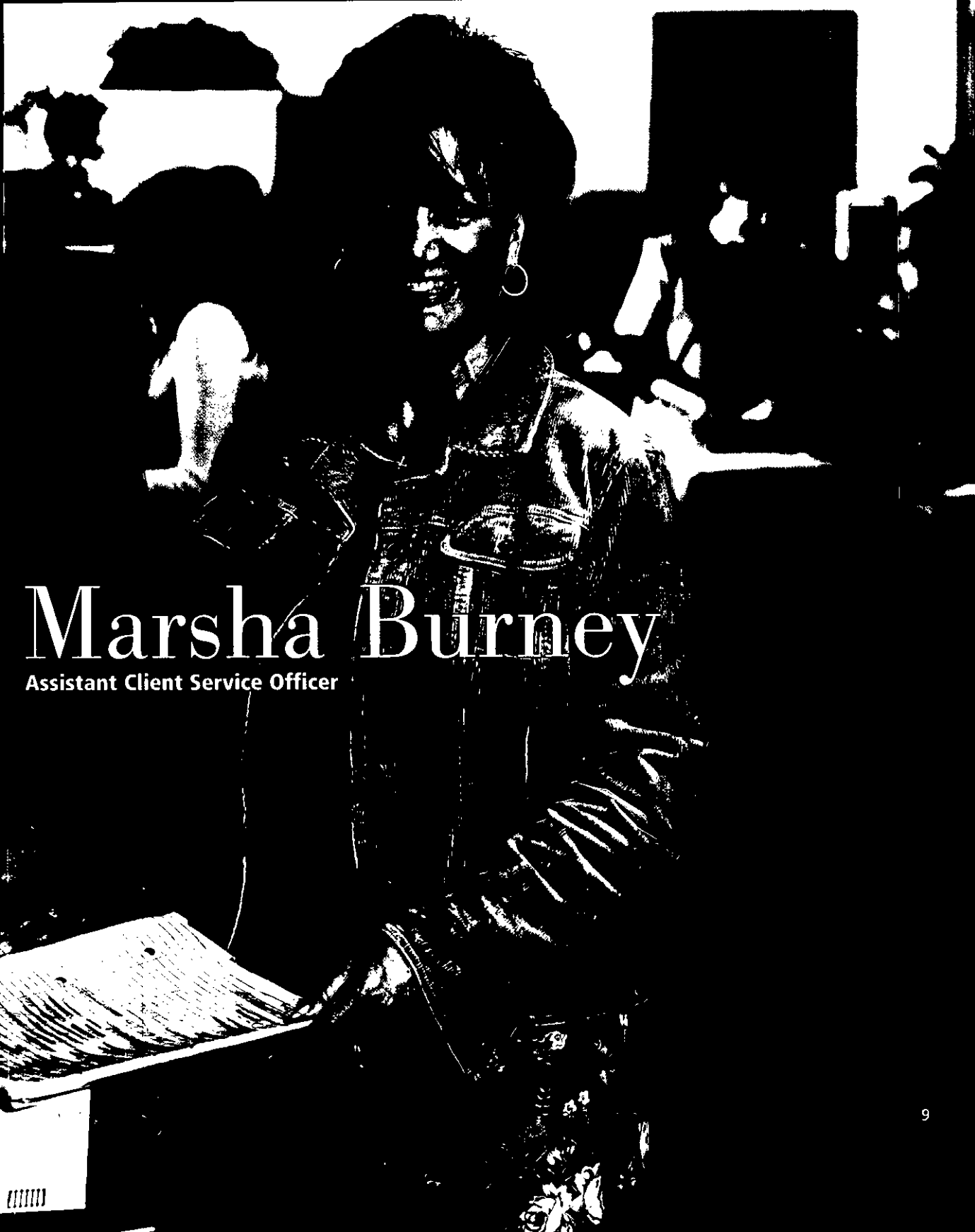
American River Bankshares' outstanding Employee Volunteer and Community Giving Programs have created a competitive advantage in the markets we serve. In 2006, we were recognized by the Community Services Planning Council with the Hands On Sacramento Award for Encouraging Employee Volunteerism. Our program is designed to promote and support the consistent dedication and hard work of employees in our communities.

### Our Numbers

- 40** Hours Employees Receive Through our At-Work Volunteer Time Benefit
- 42** Employees that Volunteer on a Regular Basis
- 39** Non-profit Boards our Employees Sit On

### **Marsha's son is a Naval Intelligence Officer**

She enjoys being part of  
a team that is dedicated  
to problem solving and  
providing solutions.



# Marsha Burney

Assistant Client Service Officer

# AMERICAN RIVER BANKSHARES FOUNDATION

## Making the Biggest Impact Possible

The American River Bankshares Foundation was established in July 2004 to fulfill the shared vision of American River Bank, Bank of Amador and North Coast Bank to give back meaningfully to local non-profit organizations based in Amador, Placer, Sacramento and Sonoma Counties.

The mission of the Foundation is to support organizations that create opportunity, enhance self-esteem and provide physical and emotional well-being for the most vulnerable women and children.

## 2006 Grant Recipients

**Acres of Hope** Placer County

**Amador-Tuolumne Community Resources** Amador County

**Redwood Empire Food Bank** Sonoma County

**Wellspring Women's Center** Sacramento County

**Women's Empowerment** Sacramento County

## Board Members

David Taber

Michael Ziegler

Mitchell Derenzo

Charles Fite

William Robotham

## Employee Committee

Jenny Armstrong

Cindi Brown

Sherry Butler

Barbara Larson

Terry McPartlan - Korphage

Trisha Ousby

Diana Walery

**Karen knits scarves  
for everyone**

She knows every  
client by name and their  
family, too – because  
service is a pleasure,  
not a chore.

## Our Numbers

**\$70,000** Total Grant Awards

**100%** Volunteer Organization

**100%** Board Contribution



# Karen Brown

AVP & Financial Services Officer

# SHAREHOLDER LETTER

Dear Fellow Shareholder,

Consistent strategy. Consistent team. Consistent results.

In a challenging banking environment, consistency matters more than ever, and that is why we believe American River Bankshares remains a good investment.

For the banking industry, the year 2006 was definitely more of a challenge than we've seen recently, with the outlook for 2007 appearing similar. It seems that every bank across the nation is coping with increased competition, increased expenses from regulatory requirements and shrinking margins from increased funding costs due to a flat yield curve.

So how is American River Bankshares positioned to grow in this difficult climate?

American River Bankshares consistently follows a strategy that focuses on business banking, low-cost core deposits, common sense real estate lending, expense control and active capital management.

We also have a commitment to just plain outwork the competition. As a Company, we continue to position ourselves as the premier business bank in the communities we serve. We operate in markets with strong economies and with a fantastic 'Relationship Banking' business model, executed by the best team in the business.

Relationship Banking is a high-touch model that is only as good as your team. Our employees are empowered to provide high-quality service and financial solutions, with speed and flexibility. The result is challenged and rewarded employees with low turnover, high satisfaction and a strong dedication to service.

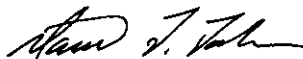
Our shareholders have continued to benefit from our consistency. In 2006, American River Bankshares delivered a 17.42% total return on investment. We also reaffirmed our shareholder value plan, which includes cash and stock dividends, a stock repurchase plan and strong earnings.

On behalf of the whole team at American River Bankshares, we thank you for your investment and for the confidence you have placed in our Company. We look forward to continuing business with you, and working to enhance your investment.

Sincerely,



Charles D. Fite  
Chairman of the Board



David T. Taber  
President & CEO



American River Bank



Bank of  
Amador

**American River Bank\***

- ① Bradshaw Plaza
- ② Capitol Mall
- ③ Fair Oaks Village
- ④ Point West
- ⑤ Roseville

**Bank of Amador\*\***

- ⑥ Buckhorn
- ⑦ Lone
- ⑧ Jackson

**North Coast Bank\*\***

- ⑨ Healdsburg
- ⑩ Santa Rosa
- ⑪ Windsor

**★ American River Bankshares Headquarters**

*This location also serves as a convenience branch for American River Bank*

**Darker area on map indicates our service area.**

\* Member FDIC / Equal Housing Lender

\*\* Bank of Amador and North Coast Bank are divisions of American River Bank

NASDAQ Symbol: AMRB

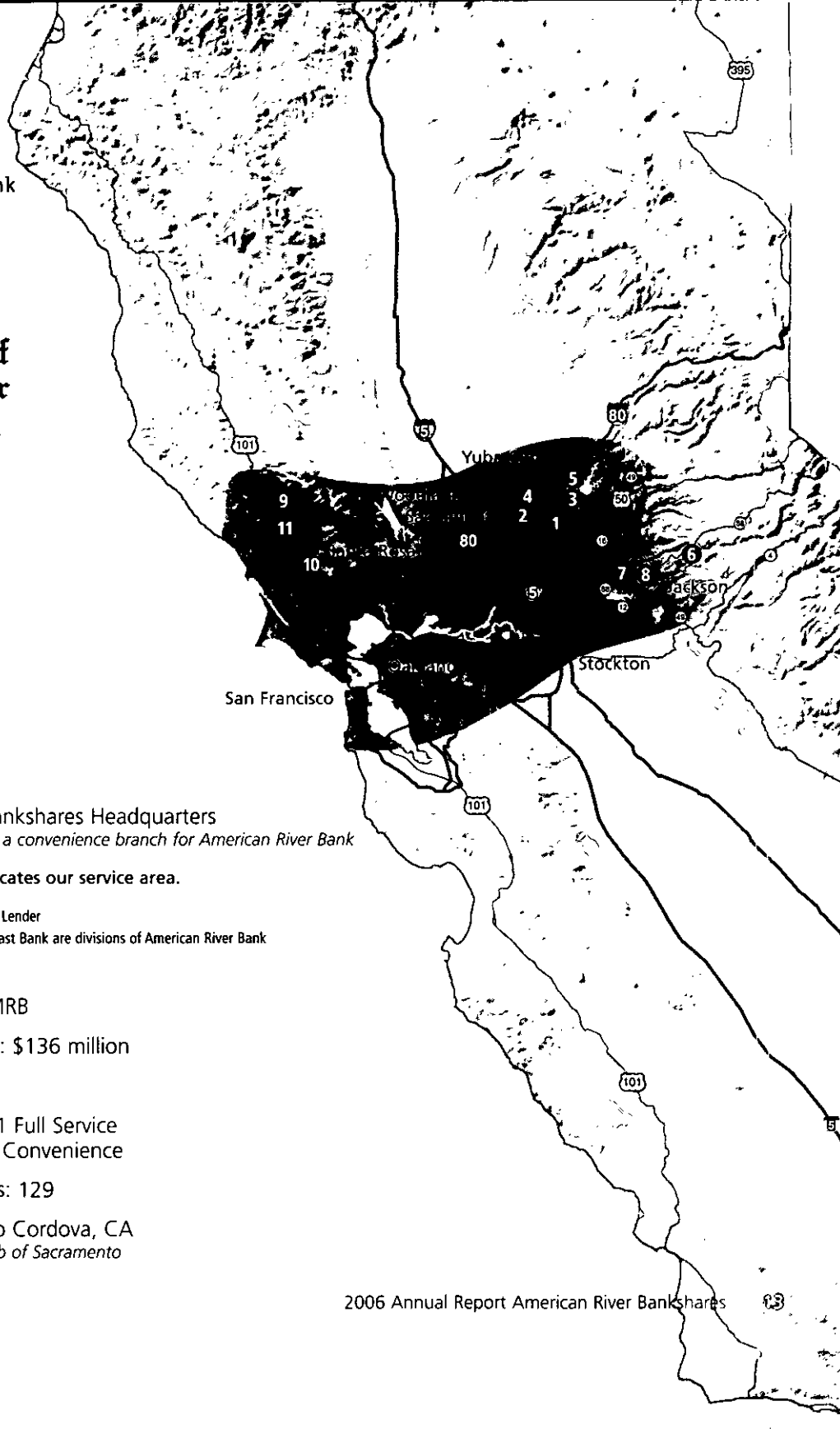
Market Capitalization: \$136 million

Year Founded: 1983

Number of Offices: 11 Full Service  
1 Convenience

Number of Employees: 129

Headquarters: Rancho Cordova, CA  
*A suburb of Sacramento*



# FINANCIAL HIGHLIGHTS

## Loan Mix

Other Real Estate \$12,307,000

Other \$25,449,000

Commercial \$85,859,000

Commercial R/E (Owner Occupied) \$87,457,000

Commercial R/E (Investor) \$88,186,000

Real Estate Construction \$90,314,000

Total loans \$389,572,000

## Deposit Mix

Savings \$36,893,000

Interest checking \$41,814,000

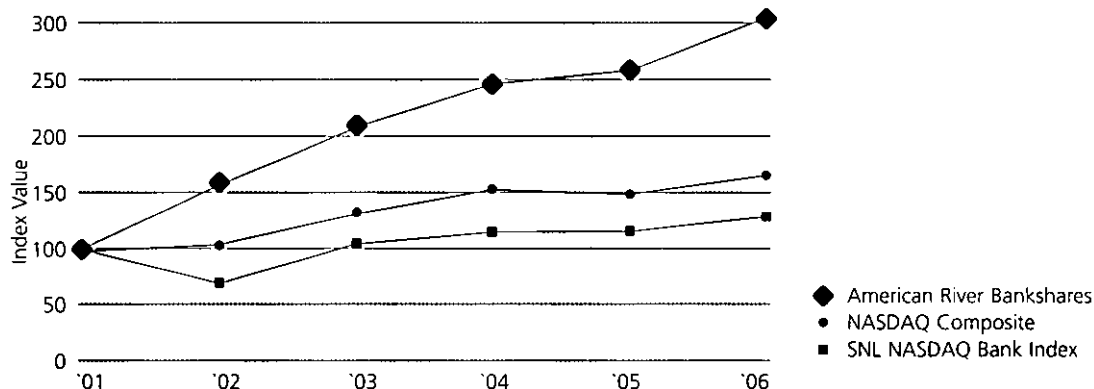
Money market \$122,765,000

Time deposits \$131,829,000

Noninterest-bearing deposits \$160,574,000

Total deposits \$493,875,000

## Total Return Performance



Index	Period Ending December 31,					
	2001	2002	2003	2004	2005	2006
American River Bankshares	100.00	160.42	210.28	247.33	261.00	306.44
NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
SNL NASDAQ Bank Index	100.00	102.85	132.76	152.16	147.52	165.62

Source: SNL Financial



## 2006 AMRB Total Return vs. Major Indexes

AMRB Shareholder Return	17.42%
NASDAQ Composite	10.28%
America's Community Bankers Index	13.37%
NYSE Composite	8.7%

*Dollars in thousands*

Statement of Operations	2006	2005	Percent Change
Net interest income	\$ 27,066	\$ 26,462	2.3%
Provision for loan and lease loss	320	322	(0.6%)
Noninterest income	2,443	2,329	4.9%
Noninterest expense	14,388	13,493	6.6%
Net income	9,062	9,184	(1.3%)

Balance Sheet	2006	2005	Percent Change
Total assets	\$ 604,003	\$ 612,763	(1.4%)
Net loans and leases	382,993	365,571	4.8%
Deposits	493,875	500,706	(1.4%)
Shareholder equity	62,371	62,746	(0.6%)

Per Share Data	2006	2005	Percent Change
Basic earnings	\$ 1.56	\$ 1.56	-
Diluted earnings	1.53	1.53	-
Book value	11.02	10.66	3.4%
Cash dividends paid per share	0.58	0.51	13.7%

Operating Ratios	2006	2005
Return on average assets	1.50%	1.54%
Return on average equity	14.48%	15.14%
Return on average tangible equity	20.33%	21.64%
Efficiency (fully taxable equivalent)	47.11%	45.16%
Net interest margin	5.03%	4.98%
Total risk based capital to risk weighted assets	11.59%	11.82%

Asset Quality Ratios	2006	2005
Allowance for loan and lease losses to loans	1.51%	1.53%
Nonperforming loans and leases to total loans and leases	0.02%	0.02%
Net chargeoffs to average loans and leases	0.03%	0.04%

# OUR TEAM

American River Bankshares  
Board of Directors

**Charles D. Fite**  
Chairman of the Board  
President, Fite Development Co.

**Roger J. Taylor, DDS**  
Vice-Chairman of the Board  
Executive Director  
Impax Health Prime  
Retired Dentist

**Stephen H. Waks, Esq.**  
Secretary to the Board  
Attorney-at-Law and Owner  
Waks Law Corporation

**Amador S. Bustos**  
CEO  
Bustos Media, LLC

**Dorene C. Dominquez**  
President  
Vanir Group of Companies

**Robert J. Fox, CPA**  
Partner  
S.J. Gallina & Co.

**William A. Robotham, CPA**  
Executive Partner  
Pisenti & Brinker LLP

**David T. Taber**  
President & CEO  
American River Bankshares

**Michael A. Ziegler**  
President & CEO  
Pride Industries

American River Bankshares  
Management Team

**David T. Taber**  
President & CEO

**Mitchell A. Derenzo**  
EVP & Chief Financial Officer

**Douglas E. Tow**  
EVP & Chief Credit Officer

**Kevin B. Bender**  
EVP & Chief Information Officer

**Gregory N. Patton**  
President, American River Bank

**Raymond F. Byrne**  
President, North Coast Bank

**Larry D. Standing**  
President, Bank of Amador

American River Bank  
Board of Directors

**Charles D. Fite**  
Chairman of the Board

**Roger J. Taylor, DDS**  
Vice Chairman

**Robert J. Fox, CPA**  
**William A. Robotham, CPA**

**Larry D. Standing**  
**David T. Taber**

**Richard P. Vinson**  
Amador County Board of  
Supervisors/Retired

**Stephen H. Waks, Esq**  
**Philip A. Wright**  
Owner

Prudential California Realty  
**Michael A. Ziegler**

Director Emeritus

**Sam J. Gallina**  
CPA, Retired  
S.J. Gallina & Co.

North Coast Bank  
Regional Community Bank Board

**Raymond F. Byrne**

**Leo J. Becnel, O.D.**  
Optometrist & Managing Partner  
Windsor Medical Center

**Pam Chanter**  
Vice President  
Matsen Insurance Brokers

**Daniel Grow**  
Bank Consultant  
Grow Associates, LLC

**Herb Liberman**  
Economic Development Coordinator  
Healdsburg Chamber of Commerce  
& Visitors Bureau

**Dennis Murphy**  
Partner  
Murphy-Goode Winery

**William A. Robotham, CPA**

**Herbert C. Steiner**  
Pharmacist & Owner  
Cloverdale Pharmacy

**Philip A. Wright**

Stock Listing  
American River Bankshares trades  
on the NASDAQ Global Select  
Stock Market under the symbol  
"AMRB"

AMRB is a member of America's  
Community Bank NASDAQ Index  
and the Russell Microcap Index by  
the Russell Investment Group

Investor Relations  
American River Bankshares  
3100 Zinfandel Drive, Suite 450  
Rancho Cordova, CA 95670  
(916) 851-0123  
investor.relations@amrb.com  
www.amrb.com

Transfer Agent  
U.S. Stock Transfer  
1745 Gardena Avenue, 2nd Floor  
Glendale, CA 91204  
1-800-835-8778  
www.usstock.com

Annual Meeting  
The 2007 annual meeting of  
American River Bankshares will be  
held at 5:00 p.m. on May 17, 2007  
at: North Ridge Country Club  
7600 Madison Avenue  
Fair Oaks, CA 95628

# FINANCIAL TABLE OF CONTENTS

Selected Financial Data	18
Management's Discussion and Analysis of Financial Condition and Results of Operations	19-38
Selected Quarterly Information	39
Report of Management on Internal Control Over Financial Reporting	40
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting	41
Report of Independent Registered Public Accounting Firm	42
Consolidated Balance Sheet, December 31, 2006 and 2005	43
Consolidated Statement of Income for the Years Ended December 31, 2006, 2005 and 2004	44
Consolidated Statement of Changes in Shareholders' Equity for the Years Ended December 31, 2006, 2005 and 2004	45
Consolidated Statement of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004	46-47
Notes to Consolidated Financial Statements	48-75

## Selected Financial Data

**FINANCIAL SUMMARY**-The following table presents certain consolidated financial information concerning the business of the Company and its subsidiaries. This information should be read in conjunction with the Consolidated Financial Statements, the notes thereto, and Management's Discussion and Analysis included in this report. All per share data has been retroactively restated to reflect stock dividends and stock splits. In December 2004, the Company completed a merger with Bank of Amador. The merger transaction was accounted for using the purchase method of accounting and accordingly the results of their operations are included in the table below from the date of acquisition.

*As of and for the Years Ended December 31, (In thousands, except per share amounts and ratios)*

Statement Of Operations Data:	2006	2005	2004	2003	2002
Net interest income	\$ 27,066	\$ 26,462	\$ 19,418	\$ 16,866	\$ 15,073
Provision for loan and lease losses	320	322	895	946	644
Other income	2,443	2,329	2,395	2,253	2,323
Other expenses	14,388	13,493	11,713	10,372	9,389
Income before income taxes	14,801	14,976	9,205	7,801	7,363
Income taxes	5,739	5,792	3,378	3,060	2,904
Net income	\$ 9,062	\$ 9,184	\$ 5,827	\$ 4,741	\$ 4,459
Earnings per share – basic	\$ 1.56	\$ 1.56	\$ 1.18	\$ 1.03	\$ 0.97
Earnings per share – diluted	1.53	1.53	1.13	0.95	0.91
Cash dividends per share	0.58	0.51	0.40	0.26	0.20
Book value per share	11.02	10.66	10.07	7.55	6.96
Tangible book value per share	7.87	7.60	6.94	7.54	6.94
Balance Sheet Data:					
Balance sheet totals-end of period:					
Assets	\$ 604,003	\$ 612,763	\$ 586,666	\$ 397,393	\$ 342,563
Loans and leases, net	382,993	365,571	352,467	262,464	229,008
Deposits	493,875	500,706	475,387	322,507	275,796
Shareholders' equity	62,371	62,746	58,990	35,457	31,726
Average balance sheet amounts:					
Assets	\$ 603,040	\$ 596,670	\$ 439,012	\$ 363,175	\$ 309,574
Loans and leases	381,465	360,319	277,647	248,342	209,133
Earning assets	544,794	537,031	400,265	333,800	280,623
Deposits	488,026	494,905	357,420	279,883	263,323
Shareholders' equity	62,570	60,641	39,163	33,461	29,509
Selected Ratios:					
For the year:					
Return on average equity	14.48%	15.14%	14.88%	14.17%	15.11%
Return on average assets	1.50%	1.54%	1.33%	1.31%	1.44%
Efficiency ratio*	47.11%	45.16%	53.12%	53.73%	53.43%
Net interest margin*	5.03%	4.98%	4.90%	5.10%	5.43%
Net chargeoffs to average loans & leases	0.03%	0.04%	0.08%	0.08%	0.03%
At December 31:					
Average equity to average assets	10.38%	10.16%	8.92%	9.21%	9.53%
Leverage capital ratio	7.81%	7.66%	8.35%	8.96%	8.93%
Allowance for loan and leases losses to total loans and leases	1.51%	1.53%	1.54%	1.48%	1.38%

\*fully taxable equivalent

## Management's Discussion and Analysis of Financial Condition and Results of Operations

*The following is American River Bankshares management's discussion and analysis of the significant changes in income and expense accounts for the years ended December 31, 2006, 2005, and 2004.*

### Cautionary Statements Regarding Forward-Looking Statements

Certain matters discussed or incorporated by reference in this Annual Report including, but not limited to, matters described herein are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as "believe," "expect," "anticipate," "intend," "may," "will," "should," "could," "would," and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following: (1) variances in the actual versus projected growth in assets; (2) return on assets; (3) loan and lease losses; (4) expenses; (5) changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits; (6) competition effects; (7) fee and other noninterest income earned; (8) general economic conditions nationally, regionally, and in the operating market areas of the Company and its subsidiaries; (9) changes in the regulatory environment; (10) changes in business conditions and inflation; (11) changes in securities markets; (12) data processing problems; (13) a decline in real estate values in the Company's operating market areas; (14) the effects of terrorism, the threat of terrorism or the impact of the current military conflict in Iraq and the conduct of the war on terrorism by the United States and its allies, as well as other factors. The factors in this report and other cautionary statements and information should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in our subsequent reports filed with the Securities and Exchange Commission on Forms 10-K, 10-Q and 8-K.

### Critical Accounting Policies

#### *General*

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. We use historical loss data, peer group experience and the economic environment as factors, among others, in determining the inherent loss that may be present in our loan and lease portfolio. Actual losses could differ significantly from the historical factors that we use. Other estimates that we use are related to the expected useful lives of our depreciable assets. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

#### *Allowance for Loan and Lease Losses*

The allowance for loan and lease losses is an estimate of the credit loss risk in our loan and lease portfolio. The allowance is based on two basic principles of accounting: (1) Statement of Financial Accounting Standards ("SFAS") No. 5 "Accounting for Contingencies," which requires that losses be accrued when it is probable that a loss has occurred at the balance sheet date and such loss can be reasonably estimated; and (2) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," which requires that losses be accrued on impaired loans based on the differences between the value

of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses an historical loss view as an indicator of future losses and as a result could differ from the loss incurred in the future. However, since our analysis of risk and loss potential is updated regularly, the errors that might otherwise occur are mitigated. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk ratings, or some combination of these factors), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short term. For further information regarding our allowance for loan and lease losses, see "Allowance for Loan and Lease Losses Activity".

#### ***Stock-Based Compensation***

The Company previously accounted for its stock-based compensation under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Because the Company's 2000 Stock Option Plan provides for the issuance of options at a price of no less than the fair market value at the date of the grant, no compensation expense was recognized in the financial statements unless the options were modified after the grant date.

In December 2004, the Financial Accounting Standards Board issued Statement Number 123 (revised 2004) ("FAS 123 (R)"), *Share-Based Payments*. FAS 123 (R) requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments such as stock options granted to employees. The Company adopted FAS 123 (R) on a modified prospective method, beginning on January 1, 2006. Under this method, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. As a result of adopting Statement 123(R) on January 1, 2006, the Company's income before provision for income taxes and net income for the year ended December 31, 2006, was \$221,000 and \$184,000 lower, respectively, than if it had continued to account for share-based compensation under APB Opinion No. 25. Diluted earnings per share and basic earnings per share for the year ended December 31, 2006 would have increased \$0.04 and \$0.03, respectively, had the Company continued to account for share-based compensation under APB Opinion No. 25.

The fair value of each option is estimated on the date of grant and amortized over the service period using an option pricing model. Critical assumptions that affect the estimated fair value of each option include expected stock price volatility, dividend yields, option life and the risk-free interest rate.

#### ***Goodwill***

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually following the year of acquisition. The Company performed an evaluation of the goodwill, recorded as a result of the Bank of Amador acquisition, during the fourth quarter of 2006 and determined that there was no impairment. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes in earnings, the effective tax rate, historical earnings multiples and the cost of capital could all cause different results for the calculation of the present value of future cash flows.

#### ***Overview***

The Company recorded its 92nd consecutive profitable quarter for the quarter ended December 31, 2006. Net income in 2006 decreased 1.3% to \$9,062,000 versus \$9,184,000 in 2005. Diluted earnings per share for 2006 and 2005 were identical—\$1.53. For 2006, the Company realized a return on average equity of 14.48% and a return on average assets of 1.50%, as compared to 15.14% and 1.54% for 2005.

Net income for 2005 was \$3,357,000 (57.6%) higher than the \$5,827,000 recorded in 2004. Diluted earnings per share in 2004 were \$1.13, return on average assets was 1.33% and return on average equity was 14.88%. During December of 2004, the Company completed a merger with Bank of Amador, therefore, 2005 includes the first full year of results from Bank of Amador.

All share and per share data for 2006, 2005 and 2004 have been adjusted for 5% stock dividends distributed on December 22, 2006, December 23, 2005 and January 28, 2005.

Table One below provides a summary of the components of net income for the years indicated:

Table One: Components of Net Income

For the twelve months ended: (in thousands, except percentages)

	2006	2005	2004
Net interest income*	\$ 27,396	\$ 26,767	\$ 19,602
Provision for loan and lease losses	(320)	(322)	(895)
Noninterest income	2,443	2,329	2,395
Noninterest expense	(14,388)	(13,493)	(11,713)
Provision for income taxes	(5,739)	(5,792)	(3,378)
Tax equivalent adjustment	(330)	(305)	(184)
Net income	\$ 9,062	\$ 9,184	\$ 5,827
Average total assets	\$ 603,040	\$ 596,670	\$ 439,012
Net income as a percentage of average total assets	1.50%	1.54%	1.33%

\*Fully taxable equivalent basis (FTE)

During 2006, total assets of the Company decreased \$8,760,000 (1.4%) to a total of \$604,003,000 at year-end. At December 31, 2006, net loans totaled \$382,993,000, up \$17,422,000 (4.8%) from the ending balances on December 31, 2005. Deposits decreased 1.4% during 2006 resulting in ending deposit balances of \$493,875,000. The Company ended 2006 with a Tier 1 capital ratio of 10.3% and a total risk-based capital ratio of 11.6%.

## Results of Operations

### Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans, securities, federal funds sold and investments in time deposits) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets.

The Company's fully taxable equivalent net interest margin was 5.03% in 2006 and 4.98% in 2005. The fully taxable equivalent net interest margin in dollars was up \$629,000 (2.3%) in 2006 over 2005.

The fully taxable equivalent interest income component increased from \$33,518,000 in 2005 to \$38,284,000 in 2006, representing a 14.2% increase. The increase in the fully taxable equivalent interest income for 2006 compared to the same period in 2005 is broken down by rate (up \$3,681,000) and volume (up \$1,085,000). The rate increase can be attributed to increases implemented by the Company during 2004 and 2005 and continuing through the end of 2006 in response to the Federal Reserve Board (the "FRB") increases in the Federal funds and Discount rates. Increases by the FRB have resulted in seventeen 25 basis point increases since June 2004. The overall increasing interest rate environment since June 2004 has resulted in a 79 basis point increase in the yield on average earning assets from 6.24% for 2005 to 7.03% for 2006. The volume increase was the result of a 1.5% increase in average earning assets and a shift in balances from lower earning investment balance to higher earning loan balances. Average loan balances were up \$21,146,000 (5.9%) in 2006 over the balances in 2005, while average investment securities balances were down \$10,066,000 (6.0%). The increase in average loans is the result of concentrated focus on business lending, the demand for commercial real estate and the effects of a favorable local market.

The fully taxable equivalent interest income component increased from \$22,820,000 in 2004 to \$33,518,000 in 2005, representing a 46.9% increase. The increase in the fully taxable equivalent interest income for 2005 compared to the same period in 2004 is broken down by rate (up \$3,036,000) and volume (up \$7,662,000). The rate increase can be attributed to increases implemented by the Company during 2004 and 2005 in response to the FRB increases in the Federal funds and Discount rates. Increases by the FRB resulted in thirteen 25 basis point increases from June 2004 to December 31, 2005. The overall increasing interest rate environment over that same time period resulted in a 54 basis point increase in the yield on average earning assets from 5.70% for 2004 to 6.24% for 2005. The volume increase was the result of a 34.2% increase in average earning assets. Average loan balances were up \$82,672,000 (29.8%) in 2005 over the balances in 2004, while average investment securities balances were up \$53,499,000 (46.7%). The increase in average loans and investments is the result of the Bank of Amador acquisition that was completed in December 2004, and a concentrated focus on business lending, the demand for commercial real estate and the effects of a favorable local market.

Interest expense increased \$4,137,000 (61.3%) in 2006 compared to 2005. The increase in rates paid on interest bearing liabilities resulted in an increase of \$3,561,000 in interest expense. The rates paid on interest bearing liabilities increased 107 basis points on a year-over-year basis and was a result of the higher overall interest rate environment as well as an increase in higher cost other borrowings. The increase in other borrowings is primarily the result of a decline in deposit balances—both interest bearing and noninterest bearing. The decline in deposit balances is primarily related to an increase in the number of financial institutions in the Sacramento market. In addition, the Company has seen a decline in the deposit balances in a number of its business accounts as a result of these businesses paying down debt and/or investing in real estate or business inventory. Although these balances declined the customer relationships were maintained and the decreasing deposit balances were replaced with funds from other borrowing sources. The average balances on interest bearing liabilities were \$5,226,000 (1.4%) higher in 2006 versus 2005. The higher balances accounted for a \$576,000 increase in interest expense. In 2006, average deposits were down \$6,879,000 (1.4%) and other borrowings were up \$11,687,000 (33.4%)

Interest expense increased \$3,533,000 (109.8%) in 2005 compared to 2004. The average balances on interest bearing liabilities were \$91,680,000 (32.5%) higher in 2005 versus 2004. The higher balances accounted for a \$1,028,000 increase in interest expense. The higher balances were due to the Bank of Amador acquisition and internal growth of average interest bearing deposits. The increase in rates paid on interest bearing liabilities resulted in an increase of \$2,505,000 in interest expense. The rates paid on interest bearing liabilities increased 67 basis points on a year-over-year basis and was a result of the higher interest rate environment.

Table Two, Analysis of Net Interest Margin on Earning Assets, and Table Three, Analysis of Volume and Rate Changes on Net Interest Income and Expenses, are provided to enable the reader to understand the components and past trends of the Company's interest income and expenses. Table Two provides an analysis of net interest margin on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net interest margin on earning assets. Table Three sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates.



Table Two: Analysis of Net Interest Margin on Earning Assets

(Taxable Equivalent Basis)

(In thousands, except percentages)

Year Ended December 31,	2006			2005			2004		
	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield
<b>Assets:</b>									
<b>Earning assets</b>									
Loans and leases (1)	\$ 381,465	\$ 31,082	8.15%	\$ 360,319	\$ 26,536	7.36%	\$ 277,647	\$ 18,115	6.52%
Taxable investment securities	129,608	5,545	4.28%	141,855	5,436	3.83%	101,728	3,751	3.69%
Tax-exempt investment securities (2)	27,886	1,355	4.86%	25,705	1,228	4.78%	12,324	713	5.79%
Corporate stock	559	42	7.51%	559	40	7.16%	568	40	7.04%
Federal funds sold	359	19	5.29%	2,826	90	3.18%	2,711	67	2.47%
Investments in time deposits	4,917	241	4.90%	5,767	188	3.26%	5,287	134	2.53%
Total earning assets	544,794	38,284	7.03%	537,031	33,518	6.24%	400,265	22,820	5.70%
Cash & due from banks	28,401			29,566			30,263		
Other assets	35,708			35,760			12,836		
Allowance for loan & lease losses	(5,863)			(5,687)			(4,352)		
	<u>\$ 603,040</u>			<u>\$ 596,670</u>			<u>\$ 439,012</u>		
<b>Liabilities &amp; Shareholders' Equity:</b>									
<b>Interest bearing liabilities:</b>									
NOW & MMDA	\$ 168,128	3,204	1.91%	\$ 185,634	2,247	1.21%	\$ 146,041	1,099	0.75%
Savings	34,911	242	0.69%	39,102	150	0.38%	24,527	56	0.23%
Time deposits	128,955	5,231	4.06%	113,719	3,249	2.86%	72,987	1,356	1.86%
Other borrowings	46,690	2,211	4.74%	35,003	1,105	3.16%	38,223	707	1.85%
Total interest bearing liabilities	378,684	10,888	2.88%	373,458	6,751	1.81%	281,778	3,218	1.14%
Demand deposits	156,032			156,450			113,865		
Other liabilities	5,754			6,121			4,206		
Total liabilities	540,470			536,029			399,849		
Shareholders' equity	62,570			60,641			39,163		
	<u>\$ 603,040</u>			<u>\$ 596,670</u>			<u>\$ 439,012</u>		
Net interest income & margin (3)		<u>\$ 27,396</u>	<u>5.03%</u>		<u>\$ 26,767</u>	<u>4.98%</u>		<u>\$ 19,602</u>	<u>4.90%</u>

(1) Loan and lease interest includes loan and lease fees of \$873,000, \$1,091,000 and \$741,000 in 2006, 2005 and 2004, respectively.

(2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34.3% in 2006 and 34.0% in 2005 and 2004.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

Table Three: Analysis of Volume and Rate Changes on Net Interest Income and Expenses

Year ended December 31, 2006 over 2005 (dollars in thousands)

Increase (decrease) due to change in:

## Interest-earning assets:

Net loans and leases (1)(2)

Taxable investment securities

Tax-exempt investment securities (3)

Corporate stock

Federal funds sold &amp; other

Investment in time deposits

Total

## Interest-bearing liabilities:

Demand deposits

Savings deposits

Time deposits

Other borrowings

Total

## Interest differential

	Volume	Rate (4)	Net Change
\$ 1,557	\$ 2,989	\$ 4,546	
(469)	578	109	
104	23	127	
-	2	2	
(79)	8	(71)	
(28)	81	53	
1,085	3,681	4,766	
(212)	1,169	957	
(16)	108	92	
435	1,547	1,982	
369	737	1,106	
576	3,561	4,137	
\$ 509	\$ 120	\$ 629	

Year Ended December 31, 2005 over 2004 (in thousands)

Increase (decrease) due to change in:

## Interest-earning assets:

Net loans and leases (1)(2)

Taxable investment securities

Tax-exempt investment securities (3)

Corporate stock

Federal funds sold &amp; other

Investment in time deposits

Total

## Interest-bearing liabilities:

Demand deposits

Savings deposits

Time deposits

Other borrowings

Total

## Interest differential

	Volume	Rate (4)	Net Change
\$ 5,394	\$ 3,027	\$ 8,421	
1,480	205	1,685	
774	(259)	515	
(1)	1	-	
3	20	23	
12	42	54	
7,662	3,036	10,698	
298	850	1,148	
33	61	94	
757	1,136	1,893	
(60)	458	398	
1,028	2,505	3,533	
\$ 6,634	\$ 531	\$ 7,165	

(1) The average balance of non-accruing loans and leases is immaterial as a percentage of total loans and leases and, as such, has been included in net loans and leases.

(2) Loan and lease fees of \$873,000, \$1,091,000 and \$741,000 for the years ended December 31, 2006, 2005 and 2004, respectively, have been included in the interest income computation.

(3) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34.3% in 2006 and 34.0% in 2005 and 2004.

(4) The rate/volume variance has been included in the rate variance.

## Provision for Loan and Lease Losses

The Company provided \$320,000 for loan and lease losses in 2006 as compared to \$322,000 for 2005. Net loan charge-offs for 2006 were \$125,000 as compared to \$139,000 in 2005. In 2006, net loan charge-offs as a percentage of average loans outstanding were .03% compared to .04% in 2005. In 2004, the Company provided \$895,000 for loan and lease losses and net charge-offs were \$209,000. For further information please see "Allowance for Loan and Lease Losses Activity."

## Service Charges and Fees and Other Income

Table Four below provides a summary of the components of noninterest income for the periods indicated (dollars in thousands):

Table Four: Components of Noninterest Income

Year Ended December 31,	2006	2005	2004
Service charges on deposit accounts	\$ 783	\$ 672	\$ 551
Merchant fee income	549	509	393
Accounts receivable servicing fees	372	356	316
Bank owned life insurance	256	179	69
Income from residential lending division	192	283	187
Gain on sale of available-for-sale securities	1	48	-
Gain on life insurance death benefit	-	-	553
Other	290	282	326
	<u>\$ 2,443</u>	<u>\$ 2,329</u>	<u>\$ 2,395</u>

Noninterest income was up \$114,000 (4.9%) to \$2,443,000 in 2006 from the 2005 level. The increase in noninterest income can be attributed to increases in fees from service charges (up \$111,000 or 16.5%), increases in fees from merchant income (up \$40,000 or 7.9%), and an increase in bank owned life insurance. The Company experienced a decrease in residential lending fee income (down \$91,000 or 32.2%). The increase in service charges resulted from a restructuring of the deposit service fee tables. The increase in income from bank owned life insurance is related to the overall increase in interest rates. The income from these instruments is interest rate driven, thus increases in interest rates will result in higher income. The decrease in income from residential lending is also reflective of the increase in rates—as interest rates increase the number of refinances decreases.

Noninterest income was down \$66,000 (2.8%) to \$2,329,000 in 2005 from the 2004 level. A portion of this decrease represents the tax-free net proceeds from a life insurance policy (\$553,000) the Company received in June of 2004 as a result of the death of a former executive officer. Without the life insurance proceeds received in 2004, noninterest income for 2005 would have shown an increase of \$487,000. The increase in noninterest income can be attributed to increases in fees from service charges (up \$121,000 or 22.0%), increases in fees from merchant income (up \$116,000 or 29.5%), and an increase in residential lending fee income (up \$96,000 or 51.3%). The increase in service charges and merchant fee income is the direct result of an increased number of deposit and merchant accounts, many of which can be attributed to the Bank of Amador acquisition completed in December 2004.

## Salaries and Benefits

Salaries and benefits, which include commissions, were \$7,816,000 (up \$858,000 or 12.3%) for 2006 as compared to \$6,958,000 in 2005. The increase is primarily the result of market-condition salary adjustments, additional administrative staff to address the burden of more stringent compliance and regulatory issues, and the addition of service personnel to help achieve strategic growth in business banking. In addition, the adoption of FAS 123(R) in January of 2006 resulted in an increase in salaries and benefits of \$134,000 during 2006. See Notes 2 and 13 to the financial statements for additional information on FAS 123(R). At the end of 2006, the full-time equivalent staff was 129, up 6 from the 123 at the end of 2005.

Salaries and benefits were \$6,958,000 (up \$910,000 or 15.0%) for 2005 as compared to \$6,048,000 in 2004. The increase is primarily the result of salaries, taxes and benefits paid to the employees of the three new offices added as a result of the Bank of Amador acquisition which was completed in December 2004 (\$742,000) and cost of living raises, higher salary costs to retain key employees in a competitive market, and overall higher health care related costs. At the end of 2005, the full-time equivalent staff was 123, equal to the 123 at the end of 2004.

## Occupancy, Furniture and Equipment

Occupancy expense increased \$155,000 (12.6%) during 2006 to \$1,384,000, up from \$1,229,000 in 2005. The majority of the increase relates to normal rent increases in the Company's leased facilities and costs associated with the Company's new administration headquarters office lease at 3100 Zinfandel Drive, Rancho Cordova CA, which was occupied in

October 2005. The new office contributed \$126,000 to the increased occupancy expense. Furniture and equipment expense was \$812,000 in 2006 compared to \$918,000 in 2005, representing a \$106,000 (11.5%) decrease. The decrease in furniture and equipment expense relates to less amortization of technology related equipment. Although still being used, certain equipment has reached its fully depreciated life.

Occupancy expense increased \$276,000 (29.0%) during 2005 to \$1,229,000, up from \$953,000 in 2004. The majority of the increase relates to the three new offices added in Amador County (\$152,000), the cost associated for a full year related to the 2004 opening of a new banking office in Downtown Sacramento (\$38,000) located at 520 Capitol Mall, Suite 100, Sacramento, CA 95814, expenses related to the 2005 opening of a new Company headquarters (\$36,000) located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, CA 95670, and annual rent increases on the Company's leased facilities. Furniture and equipment expense was \$918,000 in 2005 compared to \$752,000 in 2004, representing a \$166,000 (22.1%) increase. The increase in furniture and equipment expense relates to the three new offices added in Amador County (\$166,000).

#### Other Expenses

Table Five below provides a summary of the components of noninterest expense for the periods indicated (*dollars in thousands*):

Year Ended December 31,	2006	2005	2004
Professional fees	\$ 778	\$ 732	\$ 478
Outsourced item processing	495	489	383
Telephone and postage	411	439	280
Advertising and promotion	357	331	288
Stationery and supplies	335	303	262
Amortization of intangible assets	330	352	30
Directors' expense	311	429	518
Donations	88	82	527
Other operating expenses	1,271	1,231	1,156
	<u>\$ 4,376</u>	<u>\$ 4,388</u>	<u>\$ 3,922</u>

Other expenses were \$4,376,000 (down \$12,000 or 0.3%) for 2006 as compared to \$4,388,000 for 2005. Professional fees increased \$46,000 (6.3%) and directors' expense decreased \$150,000 (35.0%). The increase in professional fees relates to the Company's decision in 2005 to outsource our network administration and some other IT related areas. The decrease in directors' expense relates to no expense in 2006 from the former Gross-Up Plan (the "Plan") as it was fully funded in 2005—the Company recorded \$148,000 in expense in 2005 related to the Plan. The Plan, which was terminated in August of 2005, compensated for the tax effects of the exercise of nonstatutory stock options. The Plan named certain non-employee Directors as participants and applied only to those options granted on August 25, 1995. In addition, the 2005 directors' expense included \$37,000 more in payment to retired directors than in 2006. The 2006 directors' expense also included \$87,000 in stock option expense related to FAS 123 (R), which was adopted by the Company on January 1, 2006. The overhead efficiency ratio on a taxable equivalent basis for 2006 was 47.1% as compared to 45.2% in 2005.

Other expenses were \$4,388,000 (up \$466,000 or 11.9%) for 2005 as compared to \$3,922,000 for 2004. The 2004 expense included a donation of \$503,000 to establish the American River Bankshares Foundation (the "Foundation"). Donations made to the Foundation in 2005 were \$455,000 less than in 2004. The actual increase in other expenses of \$466,000 and the overall lower donation to the Foundation of \$455,000 added together represent an increase in other expenses of \$921,000. This increase can be attributed to the December 2004 acquisition of Bank of Amador and the resulting three new Amador County offices (\$935,000 increase). Included in the \$935,000 increase is \$322,000 related to amortization of the core deposit intangible associated with the acquisition. The overhead efficiency ratio on a taxable equivalent basis for 2005 was 45.2% as compared to 53.1% in 2004.

#### Provision for Taxes

The effective tax rate on income was 38.8%, 38.7% and 36.7% in 2006, 2005 and 2004, respectively. The effective tax rate was greater than the federal statutory tax rate due to state tax expense (net of federal tax effect) of \$1,006,000,

\$1,033,000 and \$589,000 in these years. Tax-exempt income of \$955,000, \$896,000 and \$533,000 from investment securities in these years helped to reduce the effective tax rate. The 2004 effective tax rate was further reduced by tax-exempt income of \$553,000 from the proceeds from a life insurance policy.

### Balance Sheet Analysis

The Company's total assets were \$604,003,000 at December 31, 2006 as compared to \$612,763,000 at December 31, 2005, representing a decrease of \$9,760,000 (1.6%). The average balances of total assets during 2006 were \$603,040,000 which represents an increase of \$6,370,000 (1.1%) over the 2005 total of \$596,670,000.

### Investment Securities

The Company classifies its investment securities as trading, held to maturity or available for sale. The Company's intent is to hold all securities classified as held to maturity until maturity and management believes that it has the ability to do so. Securities available for sale may be sold to implement asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. Table Six below summarizes the values of the Company's investment securities held on December 31 of the years indicated.

Table Six: Investment Securities Composition

(dollars in thousands)

	2006	2005	2004
<b>Available-for-sale (at fair value)</b>			
Debt securities:			
U.S. Government agencies	\$ 28,123	\$ 49,119	\$ 46,701
Mortgage-backed securities	33,236	36,326	40,359
Obligations of states and political subdivisions	41,224	37,106	27,240
Corporate debt securities	1,003	1,014	1,114
Equity securities:			
Corporate stock	623	624	627
Total available-for-sale investment securities	<u>\$ 104,209</u>	<u>\$ 124,189</u>	<u>\$ 116,401</u>
<b>Held-to-maturity (at amortized cost)</b>			
Debt securities:			
Mortgage-backed securities	\$ 44,031	\$ 45,012	\$ 41,203
Total held-to-maturity investment securities	<u>\$ 44,031</u>	<u>\$ 45,012</u>	<u>\$ 41,203</u>

See Table Sixteen for a breakdown of the investment securities by maturity and the corresponding weighted average yields.

### Loans and Leases

The Company concentrates its lending activities in the following principal areas: 1) commercial; 2) commercial real estate; 3) multi-family real estate; 4) real estate construction (both commercial and residential); 5) residential real estate; 6) lease financing receivable; 7) agriculture; and 8) consumer loans. At December 31, 2006, these categories accounted for approximately 22%, 45%, 1%, 23%, 2%, 2%, 2% and 3%, respectively, of the Company's loan portfolio. This mix was relatively unchanged compared to 21%, 42%, 1%, 28%, 1%, 2%, 2% and 3% at December 31, 2005. Continuing economic activity in the Company's market area, new borrowers developed through the Company's marketing efforts, and credit extensions expanded to existing borrowers resulted in the Company originating over \$218 million in new loans. The Company reported net increases in balances for commercial (\$7,888,000 or 10.1%), commercial real estate (\$21,143,000 or 13.7%), and residential real estate (\$4,009,000 or 85.7%). Despite the record loan originations and the development of new borrowers, the Company experienced a decrease in multi-family real estate (\$149,000 or 4.0%), real estate construction (\$12,734,000 or 12.4%), lease financing receivable (\$1,592,000 or 20.0%), agriculture (\$767,000 or 9.4%), and consumer loans (\$188,000 or 1.6%) as a result of paydowns. Table Seven below summarizes the composition of the loan and lease portfolio for the past five years as of December 31.

Table Seven Loan and Lease Portfolio Composition

(dollars in thousands)	December 31,				
	2006	2005	2004	2003	2002
Commercial	\$ 85,859	\$ 77,971	\$ 66,864	\$ 57,346	\$ 49,231
Real estate:					
Commercial	175,643	154,500	166,263	142,249	119,977
Multi-family	3,618	3,767	2,660	5,301	7,573
Construction	90,314	103,048	90,162	37,434	32,385
Residential	8,689	4,680	5,236	1,508	1,661
Lease financing receivable	6,375	7,967	9,994	9,276	6,766
Agriculture	7,362	8,129	8,252	8,027	8,824
Consumer	11,712	11,900	9,417	5,950	6,371
	389,572	371,962	358,848	267,091	232,788
Deferred loan fees, net	(705)	(712)	(885)	(678)	(583)
Allowance for loan and Lease losses	(5,874)	(5,679)	(5,496)	(3,949)	(3,197)
Total net loans and leases	\$ 382,993	\$ 365,571	\$ 352,467	\$ 262,464	\$ 229,008

A significant portion of the Company's loans and leases are direct loans and leases made to individuals and local businesses. The Company relies substantially on local promotional activity and personal contacts by American River Bank officers, directors and employees to compete with other financial institutions. The Company makes loans and leases to borrowers whose applications include a sound purpose and a viable primary repayment source, generally supported by a secondary source of repayment.

Commercial loans consist of credit lines for operating needs, loans for equipment purchases, working capital, and various other business loan products. Consumer loans include a range of traditional consumer loan products such as personal lines of credit and loans to finance purchases of autos, boats, recreational vehicles, mobile homes and various other consumer items. Construction loans are generally comprised of commitments to customers within the Company's service area for construction of commercial properties, multi-family properties and custom and semi-custom single-family residences. Other real estate loans consist primarily of loans secured by first trust deeds on commercial and residential properties typically with maturities from 3 to 10 years and original loan to value ratios generally from 65% to 75%. Agriculture loans consist primarily of vineyard loans and development loans to plant vineyards. In general, except in the case of loans under SBA programs or Farm Services Agency guarantees, the Company does not make long-term mortgage loans; however, American River Bank has a residential lending division to assist customers in securing most forms of longer term single-family mortgage financing. American River Bank acts as a broker between American River Bank's clients and the loan wholesalers. American River Bank receives an origination fee for loans closed.

Average net loans and leases in 2006 were \$381,465,000 which represents an increase of \$21,146,000 (5.9%) over the average in 2005. Average net loans and leases in 2005 were \$360,319,000 which represents an increase of \$82,672,000 (29.8%) over the average in 2004. Loan growth in 2006 and 2005 resulted from a favorable economy in the Company's market area, new borrowers developed through the Company's marketing efforts, and credit extensions expanded to existing borrowers. Additionally, the average loan growth in 2005 increased in part due to the addition of the Bank of Amador loans at the end of 2004.

#### Risk Elements

The Company assesses and manages credit risk on an ongoing basis through a total credit culture that emphasizes excellent credit quality, extensive internal monitoring and established formal lending policies. Additionally, the Company contracts with an outside loan review consultant to periodically review the existing loan and lease portfolio. Management believes its ability to identify and assess risk and return characteristics of the Company's loan and lease portfolio is critical for profitability and growth. Management strives to continue its emphasis on credit quality in the loan and lease approval process, active credit administration and regular monitoring. With this in mind, management has designed and implemented a comprehensive loan and lease review and grading system that functions to continually assess the credit risk inherent in the loan and lease portfolio.

Ultimately, underlying trends in economic and business cycles may influence credit quality. American River Bank's business is concentrated in the Sacramento Metropolitan Statistical Area, which is a diversified economy, but with a large State of California government presence and employment base, in Sonoma County, through North Coast Bank, a division of American River Bank, whose business is focused on businesses within the three communities in which it has offices (Santa Rosa, Windsor, and Healdsburg) and in Amador County, through Bank of Amador, a division of American River Bank, whose business is focused on businesses and consumers within the three communities in which it has offices (Jackson, Pioneer, and Ione) as well as a diversified residential construction loan business in numerous Northern California counties. The economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming.

The Company has significant extensions of credit and commitments to extend credit that are secured by real estate. The ultimate repayment of these loans is generally dependent on personal or business cash flows or the sale or refinancing of the real estate. The Company monitors the effects of current and expected market conditions and other factors on the collectability of real estate loans. The more significant factors management considers involve the following: lease rate and terms, absorption and sale rates; real estate values and rates of return; operating expenses; inflation; and sufficiency of repayment sources independent of the real estate including, in some instances, personal guarantees.

In extending credit and commitments to borrowers, the Company generally requires collateral and/or guarantees as security. The repayment of such loans is expected to come from cash flow or from proceeds from the sale of selected assets of the borrowers. The Company's requirement for collateral and/or guarantees is determined on a case-by-case basis in connection with management's evaluation of the creditworthiness of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing properties, residences and other real property. The Company secures its collateral by perfecting its security interest in business assets, obtaining deeds of trust, or outright possession among other means.

In management's judgment, a concentration exists in real estate loans which represented approximately 71.4% of the Company's loan and lease portfolio at December 31, 2006, down from 71.5% at December 31, 2005. Although management believes this concentration to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Company's primary market areas in particular, could have an adverse impact on the collectability of these loans and require an increase in the provision for loan and lease losses which could adversely affect the Company's future prospects, results of operations, profitability and stock price. Management believes that its lending policies and underwriting standards will tend to minimize losses in an economic downturn; however, there is no assurance that losses will not occur under such circumstances. The Company's loan policies and underwriting standards include, but are not limited to, the following: (1) maintaining a thorough understanding of the Company's service area and originating a significant majority of its loans within that area, (2) maintaining a thorough understanding of borrowers' knowledge, capacity, and market position in their field of expertise, (3) basing real estate loan approvals not only on market demand for the project, but also on the borrowers' capacity to support the project financially in the event it does not perform to expectations (whether sale or income performance), and (4) maintaining conforming and prudent loan to value and loan to cost ratios based on independent outside appraisals and ongoing inspection and analysis by the Company's lending officers or contracted third-party professionals.

#### Nonaccrual, Past Due and Restructured Loans and Leases

Management generally places loans and leases on nonaccrual status when they become 90 days past due, unless the loan or lease is well secured and in the process of collection. Loans and leases are charged off when, in the opinion of management, collection appears unlikely.

The recorded investments in nonaccrual loans and leases and loans that were accrued and 90 days or more past due totaled \$78,000 and \$91,000 at December 31, 2006 and 2005, respectively. The related allowance for losses for these loans and leases at December 31, 2006 and December 31, 2005 was \$26,000 and \$24,000, respectively. Management believes that the allowance allocations are adequate for the inherent risk of those loans and leases. The average recorded investment in nonaccrual loans and leases for the years ended December 31, 2006, 2005 and 2004 was \$137,000, \$271,000 and \$124,000, respectively.

Interest due but excluded from interest income on nonaccrual loans and leases was not material during 2006, 2005 and 2004. In 2006, 2005 and 2004, interest income recognized from payments received on nonaccrual loans and leases was also not material.

Table Eight below sets forth nonaccrual loans and leases and loans and leases past due 90 days or more as of year-end for the past five years.

Table Eight: Non-Performing Loans and Leases

(dollars in thousands)	December 31,				
	2006	2005	2004	2003	2002
Past due 90 days or more and still accruing:					
Commercial	\$ -	\$ 24	\$ -	\$ 2	\$ 2
Real estate	13	-	-	-	-
Lease financing receivable	-	-	11	-	-
Consumer and other	-	-	-	-	-
Nonaccrual:					
Commercial	-	-	52	-	42
Real estate	12	15	113	-	160
Lease financing receivable	53	52	71	179	-
Consumer and other	-	-	-	-	2
Total non-performing loans and leases	\$ 78	\$ 91	\$ 247	\$ 181	\$ 206

There were no loan or lease concentrations in excess of 10% of total loans and leases not otherwise disclosed as a category of loans and leases as of December 31, 2006. Management is not aware of any potential problem loans or leases, which were accruing and current at December 31, 2005 or 2006, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms.

#### Allowance for Loan and Lease Losses Activity

The Company maintains an allowance for loan and lease losses ("ALLL") to cover probable losses inherent in the loan and lease portfolio, which is based upon management's estimated range of those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and recoveries and reduced by charge-offs. Actual losses for loans and leases can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management's judgment after consideration of numerous factors including but not limited to: (i) local and regional economic conditions, (ii) borrowers' financial condition, (iii) loan impairment and the related level of expected charge-offs, (iv) evaluation of industry trends, (v) industry and other concentrations, (vi) loans and leases which are contractually current as to payment terms but demonstrate a higher degree of risk as identified by management, (vii) continuing evaluations of the performing loan portfolio, (viii) ongoing review and evaluation of problem loans identified as having loss potential, (ix) quarterly review by the Board of Directors, and (x) assessments by banking regulators and other third parties. Management and the Board of Directors evaluate the ALLL and determine its appropriate level considering objective and subjective measures, such as knowledge of the borrowers' business, valuation of collateral, the determination of impaired loans or leases and exposure to potential losses.

The Company establishes general reserves in accordance with Statement of Accounting Standards ("SFAS") No. 5, *Accounting for Contingencies*, and specific reserves in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*. The ALLL is maintained by categories of the loan and lease portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on



changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

Table Nine below summarizes, for the periods indicated, the activity in the allowance for loan and lease losses.

Table Nine: Allowance for Loan and Lease Losses

(in thousands, except for percentages)	December 31,				
	2006	2005	2004	2003	2002
Average loans and leases outstanding	\$ 381,465	\$ 360,319	\$ 277,647	\$ 248,342	\$ 209,133
Allowance for loan & lease losses at beginning of period	\$ 5,679	\$ 5,496	\$ 3,949	\$ 3,197	\$ 2,614
Loans and leases charged off:					
Commercial	71	72	-	13	44
Real estate	-	-	-	-	59
Consumer	1	-	1	8	48
Lease financing receivable	78	134	268	333	-
Total	150	206	269	354	151
Recoveries of loans and leases previously charged off:					
Commercial	6	9	57	113	1
Real estate	-	-	-	47	85
Consumer	9	2	3	-	4
Lease financing receivable	10	56	-	-	-
Total	25	67	60	160	90
Net loans and leases charged off	125	139	209	194	61
Allowance acquired in merger	-	-	861	-	-
Additions to allowance charged to operating expenses	320	322	895	946	644
Allowance for loan and lease losses at end of period	\$ 5,874	\$ 5,679	\$ 5,496	\$ 3,949	\$ 3,197
Ratio of net charge-offs to average loans and leases outstanding	.03%	.04%	.08%	.08%	.03%
Provision for loan and lease losses to average loans and leases outstanding	.08%	.09%	.32%	.38%	.31%
Allowance for loan and lease losses to loans and leases, net of deferred fees, at end of period	1.51%	1.53%	1.54%	1.48%	1.38%

The allowance for loan and lease losses totaled \$5,874,000 or 1.51% of total loans and leases at December 31, 2006, \$5,679,000 or 1.53% of total loans and leases at December 31, 2005, and \$5,496,000 or 1.54% at December 31, 2004.

It is the policy of management to maintain the allowance for loan and lease losses at a level adequate for known and inherent risks in the portfolio. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that management believes is appropriate at each reporting date. Based on information currently available to analyze inherent credit risk, including economic factors, overall credit quality, historical delinquencies and a history of actual charge-offs, management believes that the provision for loan and lease losses and the allowance for loan and lease losses are prudent and adequate. Adjustments may be made based on differences from estimated loan and lease growth, the types of loans constituting this growth, changes in risk ratings within the portfolio, and general economic conditions. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty.

As part of its loan review process, management has allocated the overall allowance based on specific identified problem loans and leases, qualitative factors, uncertainty inherent in the estimation process and historical loss data. A risk exists that future losses cannot be precisely quantified or attributed to particular loans or leases or classes of loans and leases. Management continues to evaluate the loan and lease portfolio and assesses current economic conditions that will affect management's conclusion as to future allowance levels. Table Ten below summarizes the allocation of the allowance for loan and lease losses for the five years ended December 31, 2006. The allocation presented should not be interpreted as an indication that charges to the allowance for loan and lease losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan and lease category represents the total amounts available for charge-offs that may occur within these categories.

Table Ten: Allowance for Loan and Lease Losses by Loan Category (in thousands, except for percentages)  
December 31,

	2006		2005		2004		2003		2002	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
Commercial	\$ 1,269	22.1%	\$ 1,056	21.0%	\$ 1,028	18.6%	\$ 865	21.5%	\$ 660	21.1%
Real estate	4,332	71.4%	3,948	71.5%	3,825	73.7%	2,579	69.8%	2,173	69.5%
Agriculture	7	1.9%	213	2.2%	110	2.3%	201	3.0%	116	3.8%
Consumer	131	3.0%	246	3.2%	220	2.6%	91	2.2%	152	2.9%
Lease financing receivable	135	1.6%	216	2.1%	313	2.8%	213	3.5%	96	2.7%
Total allocated	\$ 5,874	100.0%	\$ 5,679	100.0%	\$ 5,496	100.0%	\$ 3,949	100.0%	\$ 3,197	100.0%

#### Other Real Estate

At December 31, 2006 and 2005, the Company did not have any Other Real Estate properties.

#### Deposits

At December 31, 2006, total deposits were \$493,875,000 representing a decrease of \$6,831,000 (1.4%) over the December 31, 2005 balance of \$500,706,000. The Company's deposit growth plan for 2006 was to concentrate its efforts on increasing noninterest-bearing demand, interest-bearing money market and NOW accounts, and savings accounts. However, due to the competitive rate environment, the Company experienced slight decreases in all deposit categories, except for time deposits. During 2006, time deposits increased \$13,038,000 (11.0%) from the total of \$118,791,000 at December 31, 2005.

#### Other Borrowed Funds

Other borrowings outstanding as of December 31, 2006 consist of advances (both long-term and short-term) from the Federal Home Loan Bank (the "FHLB"). The following table summarizes these borrowings (dollars in thousands):

	2006		2005		2004	
	Amount	Rate	Amount	Rate	Amount	Rate
Short-term borrowings:						
FHLB advances	\$ 37,270	5.08%	\$ 39,386	3.73%	\$ 24,457	1.85%
Total short-term borrowings	\$ 37,270	5.08%	\$ 39,386	3.73%	\$ 24,457	1.85%
Long-term borrowings:						
FHLB advances	\$ 5,000	4.95%	\$ 4,270	4.10%	\$ 9,832	3.15%
Total long-term borrowings	\$ 5,000	4.92%	\$ 4,270	4.10%	\$ 9,832	3.15%

The maximum amount of short-term borrowings at any month-end during 2006, 2005 and 2004, was \$64,489,000, \$39,386,000, and \$40,855,000, respectively. The FHLB advances are collateralized by loans and securities pledged to the FHLB. The following is a breakdown of rates and maturities on FHLB advances (*dollars in thousands*):

	Short Term	Long Term
Amount	\$ 37,270	\$ 5,000
Maturity	2007	2008
Average rates	5.08%	4.92%

The Company has also been issued a total of \$3,500,000 in letters of credit by the FHLB which have been pledged to secure Local Agency Deposits. The letters of credit act as a guarantee of payment to certain third parties in accordance with specified terms and conditions. The letters of credit were not drawn upon in 2006 or 2005 and management does not expect to draw upon these lines in the future.

### Capital Resources

The current and projected capital position of the Company and the impact of capital plans and long-term strategies is reviewed regularly by management. The Company's capital position represents the level of capital available to support continuing operations and expansion.

On September 20, 2001, the Company announced a plan to repurchase, as conditions warrant, up to 5% annually of the Company's common stock. Each year the Company may repurchase up to 5% of the shares outstanding (adjusted for stock splits or stock dividends). The repurchases are to be made from time to time in the open market as conditions allow and will be structured to comply with Commission Rule 10b-18. Management reports monthly to the Board of Directors on the status of the repurchase program. The Board of Directors has reserved the right to suspend, terminate, modify or cancel this repurchase program at any time for any reason. During 2006, the Company repurchased 271,573 shares; during 2005, the Company repurchased 84,341 shares; during 2004, the Company repurchased 10,766 shares, in 2003, the company repurchased 1,737 shares and in 2002, the Company repurchased 75,961 shares under the repurchase plan.

The Company and American River Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and American River Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. At December 31, 2006, shareholders' equity was \$62,371,000, representing a decrease of \$375,000 (0.6%) from \$62,746,000 at December 31, 2005. This decrease was attributable principally to the retention of earnings offset by the payment of cash dividends and the repurchase of Company stock. In 2005, shareholders' equity increased \$3,756,000 (6.4%) from 2004. The ratio of total risk-based capital to risk adjusted assets was 11.6% at December 31, 2006 compared to 11.8% at December 31, 2005. Tier 1 risk-based capital to risk-adjusted assets was 10.3% at December 31, 2006 and 10.6% at December 31, 2005.

Table Eleven below lists the Company's actual capital ratios at December 31, 2006 and 2005 as well as the minimum capital ratios for capital adequacy.

Table Eleven: Capital Ratios

	At December 31,		Minimum Regulatory Capital Requirements
	2006	2005	
<b>Capital to Risk-Adjusted Assets</b>			
Leverage ratio	7.8%	7.6%	4.00%
Tier 1 Risk-Based Capital	10.3%	10.6%	4.00%
Total Risk-Based Capital	11.6%	11.8%	8.00%

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet future needs. American River Bank's ratios are in excess of the regulatory definition of "well capitalized."

Management believes that the Company's capital is adequate to support current operations and anticipated growth, cash dividends and future capital requirements of the Company and its subsidiaries.

### Market Risk Management

**Overview.** Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan and deposit functions. The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the interest rate risk management policies. The Company has a Risk Management Committee that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

**Asset/Liability Management.** Activities involved in asset/liability management include, but are not limited to, lending, accepting and placing deposits and investing in securities. Interest rate risk is the primary market risk associated with asset/liability management. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. To mitigate interest rate risk, the structure of the consolidated balance sheet is managed with the goal that movements of interest rates on assets and liabilities are correlated and contribute to earnings even in periods of volatile interest rates. The asset/liability management policy sets limits on the acceptable amount of variance in net interest margin and market value of equity under changing interest environments. The Company uses simulation models to forecast earnings, net interest margin and market value of equity.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, the Company is able to estimate the potential impact of changing interest rates on earnings. A balance sheet forecast is prepared quarterly using inputs of actual loans and leases, securities and interest bearing liabilities (i.e. deposits/borrowings) positions as the beginning base. The forecast balance sheet is processed against three interest rate scenarios. The scenarios include a 200 basis point rising rate forecast, a flat rate forecast and a 200 basis point falling rate forecast which take place within a one year time frame. The net interest income is measured during the year assuming a gradual change in rates over the twelve-month horizon. The simulation modeling indicated below attempts to estimate changes in the Company's net interest income utilizing a forecast balance sheet projected from year-end balances.

Table Twelve below summarizes the effect on net interest income (NII) of a  $\pm 200$  basis point change in interest rates as measured against a constant rate (no change) scenario.

Table Twelve: Interest Rate Risk Simulation of Net Interest as of December 31, 2006

Variation from a constant rate scenario	\$ Change in NII from Current	
	12 Month Horizon	
+200bp	\$	87
-200bp	\$	(295)

The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as reasonable estimates of interest rate risk.

### Interest Rate Sensitivity Analysis

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity is measured as the difference between the volumes of assets and liabilities in the current portfolio that are subject to repricing at various time horizons. The differences are known as interest sensitivity gaps. Table Thirteen below lists the maturity or repricing time buckets as of December 31, 2006.

Table Thirteen: Interest Rate Sensitivity

December 31, 2006 (dollars in thousands)

Assets and Liabilities which mature or reprice within (days):

	0-90	91-180	181-365	Over 365	Non-repricing	Total
<b>Assets:</b>						
Investments	\$ 14,847	\$ 7,398	\$ 15,557	\$ 118,460	\$ -	\$ 156,262
Loans and leases	171,150	27,871	34,259	149,713	-	382,993
Other assets	-	-	-	-	64,748	64,748
<b>Total assets</b>	<b>\$ 185,997</b>	<b>\$ 35,269</b>	<b>\$ 49,816</b>	<b>\$ 268,173</b>	<b>\$ 64,748</b>	<b>\$ 604,003</b>
<b>Liabilities:</b>						
Noninterest bearing	\$ -	\$ -	\$ -	\$ -	\$ 160,574	\$ 160,574
Interest bearing:						
NOW Accounts	20,908	8,363	6,271	6,272	-	41,814
Money market	61,380	24,552	18,417	18,416	-	122,765
Savings	18,446	7,378	3,690	7,379	-	36,893
Time certificates	63,739	28,154	21,741	18,195	-	131,829
Short-term borrowings	24,000	2,500	10,770	-	-	37,270
Long-term borrowings	-	-	-	5,000	-	5,000
Other liabilities	-	-	-	-	5,487	5,487
Shareholders' equity	-	-	-	-	62,371	62,371
<b>Total liabilities and shareholders' equity</b>	<b>\$ 188,473</b>	<b>\$ 70,947</b>	<b>\$ 60,889</b>	<b>\$ 55,262</b>	<b>\$ 228,432</b>	<b>\$ 604,003</b>
<b>Interest rate sensitivity gap</b>	<b>\$ (2,476)</b>	<b>\$ (35,678)</b>	<b>\$ (11,073)</b>	<b>\$ 212,911</b>	<b>\$(163,684)</b>	
<b>Cumulative interest rate sensitivity gap</b>	<b>\$ (2,476)</b>	<b>\$ (38,154)</b>	<b>\$ (49,227)</b>	<b>\$ 163,684</b>	<b>-</b>	

A positive cumulative gap may be equated to an asset sensitive position. An asset sensitive position in a rising interest rate environment will cause a bank's interest rate margin to expand. This results as floating or variable rate loans reprice more rapidly than fixed rate certificates of deposit that reprice as they mature over time. Conversely, a declining interest rate environment will cause the opposite effect. A negative cumulative gap may be equated to a liability sensitive position. A liability sensitive position in a rising interest rate environment will cause a bank's interest rate margin to contract, while a declining interest rate environment will have the opposite effect. As reflected in Table Thirteen, at December 31, 2006, the cumulative gap through the one-year time horizon indicates a liability sensitive position.

### Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing, or other commercial concerns, primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company through its effect on market rates of interest, which affects the Company's ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand, and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a material effect upon the results of operations of the Company during the years ended December 31, 2006, 2005 and 2004.

## Liquidity

Liquidity management refers to the Company's ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company's liquidity position. Federal funds lines, short-term investments and securities, and loan and lease repayments contribute to liquidity, along with deposit increases, while loan and lease funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans and outstanding standby letters of credit at December 31, 2006 were approximately \$114,582,000 and \$5,701,000, respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company's sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale. On December 31, 2006, consolidated liquid assets totaled \$65.9 million or 10.9% of total assets compared to \$99.2 million or 16.2% of total assets on December 31, 2005. In addition to liquid assets, the Company maintains short-term lines of credit in the amount of \$53,000,000 with correspondent banks. At December 31, 2006, the Company had \$53,000,000 available under these credit lines. Additionally, American River Bank is a member of the FHLB. At December 31, 2006, American River Bank could have arranged for up to \$132,861,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At December 31, 2006, the Company had \$84,091,000 available under these secured borrowing arrangements. American River Bank also has informal agreements with various other banks to sell participations in loans, if necessary. The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets to volatile and cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. These securities are also available to pledge as collateral for borrowings if the need should arise. American River Bank has established a master repurchase agreement with a correspondent bank to enable such transactions. American River Bank can also pledge securities to borrow from the FRB and the FHLB.

The principal cash requirements of the Company are for expenses incurred in the support of administration and operations. For nonbanking functions, the Company is dependent upon the payment of cash dividends from its subsidiaries to service its commitments. The Company expects that the cash dividends paid by American River Bank to the Company will be sufficient to meet this payment schedule. The maturity distribution of certificates of deposit is set forth in Table Fourteen below for the periods presented. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available.

**Table Fourteen: Certificates of Deposit Maturities**  
December 31, 2006 (*dollars in thousands*)

	Less than \$100,000	Over \$100,000
Three months or less	\$ 17,473	\$ 46,266
Over three months through six months	12,512	15,641
Over six months through twelve months	10,657	11,084
Over twelve months	8,618	9,578
Total	<u>\$ 49,260</u>	<u>\$ 82,569</u>

Loan and lease demand also affects the Company's liquidity position. Table Fifteen below presents the maturities of loans and leases for the period indicated.

Table Fifteen: Loan and Lease Maturities (Gross Loans and Leases)

December 31, 2006 (dollars in thousands)	One year or less	One year through five years	Over five years	Total
Commercial	\$ 37,048	\$ 40,810	\$ 8,001	\$ 85,859
Real estate	97,772	50,650	129,842	278,264
Agriculture	780	865	5,717	7,362
Consumer	644	3,312	7,756	11,712
Leases	464	5,064	847	6,375
Total	<u>\$ 136,708</u>	<u>\$ 100,701</u>	<u>\$ 152,163</u>	<u>\$ 389,572</u>

Loans and leases shown above with maturities greater than one year include \$198,933,000 of floating interest rate loans and \$53,931,000 of fixed rate loans and leases.

The carrying amount, maturity distribution and weighted average yield of the Company's investment securities available-for-sale and held-to-maturity portfolios are presented in Table Sixteen below. The yields on tax-exempt obligations have been computed on a tax equivalent basis. Table Sixteen does not include FHLB Stock, which does not have stated maturity dates or readily available market values. The balance in FHLB Stock at December 31, 2006, 2005 and 2004 was \$3,071,000, \$2,608,000 and \$2,158,000, respectively.

Table Sixteen: Securities Maturities and Weighted Average Yields

(Taxable Equivalent Basis)	December 31,					
	2006		2005		2004	
(dollars in thousands)	Carrying Amount	Weighted Average Yield	Carrying Amount	Weighted Average Yield	Carrying Amount	Weighted Average Yield
<b>Available-for-sale securities:</b>						
U.S. Treasury and agency securities						
Maturing within 1 year	\$ 11,870	3.57%	\$ 21,012	3.37%	\$ 7,055	3.88%
Maturing after 1 year						
but within 5 years	16,253	3.78%	28,107	3.70%	39,645	3.41%
State & political subdivisions						
Maturing within 1 year	4,556	4.00%	-	-	1,105	4.83%
Maturing after 1 year						
but within 5 years	12,625	4.82%	15,426	4.43%	6,574	4.30%
Maturing after 5 years						
but within 10 years	13,789	6.33%	17,386	6.39%	17,393	6.16%
Maturing after 10 years	10,254	6.28%	4,294	6.37%	2,168	6.83%
Government sponsored						
mortgage-backed securities	33,236	4.30%	36,326	4.30%	40,359	4.30%
Other						
Maturing within 1 year	1,003	4.67%	-	-	1,115	2.23%
Maturing after 1 year						
but within 5 years	-	-	1,014	4.67%	-	-
Non maturing	623	6.12%	624	6.18%	627	6.63%
Total investment securities	<u>\$ 104,209</u>	<u>4.66%</u>	<u>\$ 124,189</u>	<u>4.40%</u>	<u>\$ 116,041</u>	<u>4.32%</u>
<b>Held-to-maturity securities:</b>						
Government sponsored						
mortgage-backed securities	\$ 44,031	4.66%	\$ 45,012	4.37%	\$ 41,203	4.16%
Total investment securities	<u>\$ 44,031</u>	<u>4.66%</u>	<u>\$ 45,012</u>	<u>4.37%</u>	<u>\$ 41,203</u>	<u>4.16%</u>

The carrying values of available-for-sale securities include net unrealized (losses) gains of (\$957,000), (\$1,279,000) and \$880,000 at December 31, 2006, 2005 and 2004, respectively. The carrying values of held-to-maturity securities do not include unrealized gains or losses, however, the net unrealized (losses) gains at December 31, 2006, 2005 and 2004 were (\$311,000), (\$354,000) and \$125,000, respectively.

## Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

As of December 31, 2006, commitments to extend credit and letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. Real estate commitments are generally secured by property with a loan-to-value ratio of 65% to 75%. In addition, the majority of the Company's commitments have variable interest rates.

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and letters of credit as it does for loans included on the consolidated balance sheet. The following financial instruments represent off-balance-sheet credit:

	December 31,	
	2006	2005
Commitments to extend credit ( <i>dollars in thousands</i> ):		
Revolving lines of credit secured by 1-4 family residences	\$ 9,144	\$ 16,845
Commercial real estate, construction and land development commitments secured by real estate	45,752	55,313
Other unused commitments, principally commercial loans	59,686	65,644
	<u>\$ 114,582</u>	<u>\$ 137,802</u>
Letters of credit	<u>\$ 5,701</u>	<u>\$ 3,393</u>

Certain financial institutions have elected to use special purpose vehicles ("SPV") to dispose of problem assets. The SPV is typically a subsidiary company with an asset and liability structure and legal status that makes its obligations secure even if the parent corporation goes bankrupt. Under certain circumstances, these financial institutions may exclude the problem assets from their reported impaired and non-performing assets. The Company does not use those vehicles or any other structures to dispose of problem assets.

## Contractual Obligations

The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under non-cancelable operating leases are noted in Table Seventeen below. Table Seventeen below presents certain of the Company's contractual obligations as of December 31, 2006. Included in the table are amounts payable under the Company's Deferred Compensation and Deferred Fees Plans and are listed in the "Other Long-Term Liabilities..." category. These amounts represented \$1,488,000 and are anticipated to be primarily payable at least five years in the future.

Table Seventeen: Contractual Obligations

(*dollars in thousands*)

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	\$ 5,000	\$ -	\$ 5,000	\$ -	\$ -
Capital Lease Obligations	-	-	-	-	-
Operating Leases	5,665	977	1,917	1,208	1,563
Purchase Obligations	-	-	-	-	-
Other Long-Term Liabilities Reflected on the Company's Balance Sheet under GAAP	1,488	-	-	-	1,488
Total	<u>\$12,153</u>	<u>\$ 977</u>	<u>\$ 6,917</u>	<u>\$ 1,208</u>	<u>\$ 3,051</u>

## Accounting Pronouncements

On July 13, 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial



statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. An enterprise shall disclose the cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption and such disclosure is required only in the year of adoption. Management is in the process of analyzing the implications of FIN 48. Management does not anticipate that this statement will have a material effect on the Company's financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within that fiscal year. Management is in the process of evaluating the impact of adopting this statement.

#### Other Matters

**Effects of Terrorism.** The terrorist actions on September 11, 2001 and thereafter and the current military conflict in Iraq have had significant adverse effects upon the United States economy. Whether the terrorist activities in the future and the actions of the United States and its allies in combating terrorism on a worldwide basis will adversely impact the Company and the extent of such impact is uncertain. Such economic deterioration could adversely affect the Company's future results of operations by, among other matters, reducing the demand for loans and other products and services offered by the Company, increasing nonperforming loans and the amounts reserved for loan and lease losses, and causing a decline in the Company's stock price.

### Selected Quarterly Information (Unaudited)

(In thousands, except per share and price range of common stock)

	March 31,	June 30,	September 30,	December 31,
<b>2006</b>				
Interest income	\$ 9,117	\$ 9,463	\$ 9,737	\$ 9,637
Net interest income	6,792	6,699	6,798	6,777
Provision for loan and lease losses	84	156	30	50
Noninterest income	634	597	605	607
Noninterest expense	3,638	3,622	3,602	3,526
Income before taxes	3,704	3,518	3,771	3,808
Net income	2,243	2,137	2,275	2,407
Basic earnings per share	\$ .38	\$ .36	\$ .39	\$ .43
Diluted earnings per share	.37	.36	.39	.42
Cash dividends per share	.143	.143	.143	.150
Price range, common stock	\$ 20.24-27.62	\$ 24.53-27.62	\$ 23.05-25.90	\$ 23.01-25.47
<b>2005</b>				
Interest income	\$ 7,674	\$ 8,011	\$ 8,562	\$ 8,966
Net interest income	6,315	6,439	6,753	6,955
Provision for loan and lease losses	217	55	-	50
Noninterest income	581	584	594	570
Noninterest expense	3,328	3,403	3,464	3,298
Income before taxes	3,351	3,565	3,883	4,177
Net income	2,051	2,190	2,376	2,567
Basic earnings per share	\$ .35	\$ .37	\$ .40	\$ .44
Diluted earnings per share	.34	.36	.39	.43
Cash dividends per share	.113	.118	.136	.143
Price range, common stock	\$ 18.90-21.31	\$ 18.82-21.54	\$ 18.96-22.00	\$ 20.05-21.80

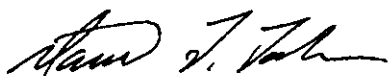
The earnings per share, cash dividends, and price range have been adjusted for 5% stock dividends in 2006 and 2005.

## Report of Management on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

The Company's management, including the Chief Executive Officer and Chief Financial Officer, has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria applicable to the Company as set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based upon such assessment, management believes that, as of December 31, 2006, the Company's internal control over financial reporting is effective based upon those criteria.

Perry-Smith LLP, the registered public accounting firm that audited the Company's consolidated financial statements included in this Annual Report, has issued a report with respect to management's assessment of the effectiveness of the Company's internal control over financial reporting. The report of Perry-Smith LLP immediately follows.



David T. Taber  
President and Chief Executive Officer



Mitchell A. Derenzo  
Executive Vice President and Chief Financial Officer

# Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

To the Board of Directors

American River Bankshares

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that American River Bankshares and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("the COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that American River Bankshares and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, American River Bankshares and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of American River Bankshares and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006 and our report dated March 7, 2007 expressed an unqualified opinion thereon.

*Perry-Smith LLP*

Sacramento, California  
March 7, 2007

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

## Report Of Independent Registered Public Accounting Firm

### The Shareholders and Board of Directors

#### American River Bankshares

We have audited the accompanying consolidated balance sheet of American River Bankshares and subsidiaries (the "Company") as of December 31, 2006 and 2005 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of American River Bankshares and subsidiaries as of December 31, 2006 and 2005, and the consolidated results of their operations and their consolidated cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

We have also audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Sacramento, California

March 7, 2007

*Perry-Smith LLP*

# Consolidated Balance Sheet

December 31, 2006 and 2005

(Dollars in thousands)

## ASSETS

	2006	2005
Cash and due from banks	\$ 25,352	\$ 34,825
Federal funds sold		1,250
Total cash and cash equivalents	25,352	36,075
Interest-bearing deposits in banks	4,951	4,844
Investment securities (Note 5):		
Available for sale, at fair value	104,209	124,189
Held to maturity, at amortized cost	44,031	45,012
Loans and leases, less allowance for loan and lease losses of \$5,874 in 2006 and \$5,679 in 2005 (Notes 6, 12 and 17)	382,993	365,571
Premises and equipment, net (Note 7)	1,846	2,090
Federal Home Loan Bank stock	3,071	2,608
Accounts receivable servicing receivables, net (Note 8)	2,581	2,000
Goodwill (Notes 3 and 4)	16,321	16,321
Intangible assets (Notes 3 and 4)	1,501	1,831
Accrued interest receivable and other assets (Notes 11 and 16)	17,147	12,222
	<u>\$ 604,003</u>	<u>\$ 612,763</u>

## Liabilities and Shareholders' Equity

Deposits:		
Noninterest bearing	\$ 160,574	\$ 164,397
Interest bearing (Note 9)	333,301	336,309
Total deposits	493,875	500,706
Short-term borrowings (Note 10)	37,270	39,386
Long-term borrowings (Note 10)	5,000	4,270
Accrued interest payable and other liabilities (Note 16)	5,487	5,655
Total liabilities	<u>541,632</u>	<u>550,017</u>
Commitments and contingencies (Note 12)		
Shareholders' equity (Notes 13 and 14):		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 5,657,346 shares in 2006 and 5,604,479 shares in 2005	48,246	47,474
Retained earnings	14,690	16,029
Accumulated other comprehensive loss, net of taxes (Notes 5 and 18)	(565)	(757)
Total shareholders' equity	<u>62,371</u>	<u>62,746</u>
	<u>\$ 604,003</u>	<u>\$ 612,763</u>

The accompanying notes are an integral part of these consolidated financial statements.

American River Bankshares and Subsidiaries Consolidated Balance Sheet

## Consolidated Statement of Income

For the Years Ended December 31, 2006, 2005 and 2004

(Dollars in thousands, except per share data)

	2006	2005	2004
Interest income:			
Interest and fees on loans and leases	\$ 31,081	\$ 26,536	\$ 18,115
Interest on Federal funds sold	19	90	67
Interest on deposits in banks	241	188	134
Interest and dividends on investment securities:			
Taxable	5,545	5,436	3,751
Exempt from Federal income taxes	1,034	931	537
Dividends	34	32	32
Total interest income	37,954	33,213	22,636
Interest expense:			
Interest on deposits (Note 9)	8,677	5,646	2,511
Interest on borrowings (Note 10)	2,211	1,105	707
Total interest expense	10,888	6,751	3,218
Net interest income	27,066	26,462	19,418
Provision for loan and lease losses (Note 6)	320	322	895
Net interest income after provision for loan and lease losses	26,746	26,140	18,523
Noninterest income:			
Service charges	783	672	551
Gain on sale of available-for-sale investment securities (Note 5)	1	48	
Other income (Note 15)	1,659	1,609	1,844
Total noninterest income	2,443	2,329	2,395
Noninterest expense:			
Salaries and employee benefits (Notes 6 and 16)	7,816	6,958	6,048
Occupancy (Notes 7 and 12)	1,384	1,229	953
Furniture and equipment (Notes 7 and 12)	812	918	752
Loss on sale of available-for-sale investment securities (Note 5)			38
Other expense (Note 15)	4,376	4,388	3,922
Total noninterest expense	14,388	13,493	11,713
Income before provision for income taxes	14,801	14,976	9,205
Provision for income taxes (Note 11)	5,739	5,792	3,378
Net income	\$ 9,062	\$ 9,184	\$ 5,827
Basic earnings per share (Note 13)	\$ 1.56	\$ 1.56	\$ 1.18
Diluted earnings per share (Note 13)	\$ 1.53	\$ 1.53	\$ 1.13
Cash dividends per share of issued and outstanding common stock, adjusted for stock dividends	\$ 0.58	\$ 0.51	\$ 0.40

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statement of Changes in Shareholders' Equity

For the Years Ended December 31, 2006, 2005 and 2004  
(Dollars in thousands)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity	Total Comprehensive Income
	Shares	Amount				
Balance, January 1, 2004	4,055,260	\$ 16,693	\$ 17,900	\$ 864	\$ 35,457	
Comprehensive income (Note 18):						
Net income			5,827		5,827	\$ 5,827
Other comprehensive loss, net of tax:						
Net change in unrealized gains on available-for-sale investment securities				(309)	(309)	(309)
Total comprehensive income						<u>\$ 5,518</u>
Stock issued in acquisition (Note 3)	775,548	18,284			18,284	
Cash dividend (\$.40 per share)			(2,044)		(2,044)	
5% stock dividend	252,392	5,805	(5,805)			
Stock options exercised	263,446	1,959			1,959	
Retirement of common stock (Note 13)	(31,914)	(184)			(184)	
Balance, December 31, 2004	5,314,732	42,557	15,878	555	58,990	
Comprehensive income (Note 18):						
Net income			9,184		9,184	\$ 9,184
Other comprehensive loss, net of tax:						
Net change in unrealized gains on available-for-sale investment securities				(1,312)	(1,312)	(1,312)
Total comprehensive income						<u>\$ 7,872</u>
Cash dividend (\$.51 per share)			(3,012)		(3,012)	
Fractional shares redeemed	(1)	(32)			(32)	
5% stock dividend	266,801	6,021	(6,021)			
Stock options exercised	113,309	945			945	
Retirement of common stock (Note 13)	(90,362)	(2,017)			(2,017)	
Balance, December 31, 2005	5,604,479	47,474	16,029	(757)	62,746	
Cumulative effect of adopting Staff Accounting Bulletin No. 108, net of taxes (Note 2)			(214)		(214)	
Comprehensive income (Note 18):						
Net income			9,062		9,062	\$ 9,062
Other comprehensive income, net of tax:						
Net change in unrealized losses on available-for-sale investment securities				192	192	192
Total comprehensive income						<u>\$ 9,254</u>
Cash dividend (\$.58 per share)			(3,332)		(3,332)	
Fractional shares redeemed for stock dividend			(21)		(21)	
5% stock dividend	268,346	6,834	(6,834)			
Stock options exercised	43,162	441			441	
Stock option compensation (Note 13)		221			221	
Retirement of common stock (Note 13)	(258,641)	(6,724)			(6,724)	
Balance, December 31, 2006	5,657,346	\$ 48,246	\$ 14,690	\$ (565)	\$ 62,371	

The accompanying notes are an integral part of these consolidated financial statements.

American River Bankshares and Subsidiaries Consolidated Statement of Changes in Shareholders' Equity

## Consolidated Statement of Cash Flow

For the Years Ended December 31, 2006, 2005 and 2004

(Dollars in thousands)

	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 9,062	\$ 9,184	\$ 5,827
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan and lease losses	320	322	895
Decrease in deferred loan and lease origination fees, net	(7)	(173)	(79)
Depreciation and amortization	951	1,014	575
Amortization of investment security premiums and discounts, net	659	1,099	1,249
Provision for accounts receivable servicing receivable allowance for losses	11	35	
(Gain) loss on sale of available-for-sale investment securities	(1)	(48)	38
Gain on life insurance death benefit			(553)
Increase in cash surrender value of life insurance policies	(192)	(178)	(69)
Provision for deferred income taxes	653	(422)	(82)
Stock option compensation expense	221		
(Increase) decrease in accrued interest receivable and other assets	(948)	179	(1,136)
(Decrease) increase in accrued interest payable and other liabilities	(525)	(12,604)	1,920
Net cash provided by (used in) operating activities	10,204	(1,592)	8,585
Cash flows from investing activities:			
Cash acquired in acquisition			26,294
Proceeds from the sale of available-for-sale investment securities	3,259	6,964	5,019
Proceeds from called available-for-sale investment securities	400	280	
Proceeds from matured available-for-sale investment securities	21,150	20,180	5,435
Proceeds from matured held-to-maturity investment securities			200
Purchases of available-for-sale investment securities	(7,275)	(41,596)	(50,875)
Purchases of held-to-maturity investment securities	(9,489)	(16,901)	(23,737)
Proceeds from principal repayments for available-for-sale mortgage-backed securities	2,275	3,411	8,507
Proceeds from principal repayments for held-to-maturity mortgage-backed securities	10,305	12,495	8,758
Net (increase) decrease in interest-bearing deposits in banks	(107)	1,095	(1,189)
Net increase in loans and leases	(17,733)	(13,242)	(12,064)
Net (increase) decrease in accounts receivable servicing receivables	(592)	374	(631)
Purchases of equipment	(379)	(886)	(704)
Death benefit from life insurance policy			1,236
Purchase of single premium life insurance policies	(4,432)		
Net increase in FHLB stock	(463)	(450)	(612)
Net cash used in investing activities	(3,081)	(28,276)	(34,363)

(Continued)



# Consolidated Statement of Cash Flow (Continued)

For the Years Ended December 31, 2006, 2005 and 2004  
(Dollars in thousands)

	2006	2005	2004
Cash flows from financing activities:			
Net (decrease) increase in demand, interest-bearing and savings deposits	\$ (19,768)	\$ 12,722	\$ 37,341
Net increase (decrease) in time deposits	12,937	12,597	(3,697)
Increase (decrease) in long-term borrowings	730	(5,562)	(53)
(Decrease) increase in short-term borrowings	(2,116)	14,929	(2,200)
Exercise of stock options, including tax benefit	441	945	1,959
Cash paid to repurchase common stock	(6,724)	(2,017)	(184)
Payment of cash dividends	(3,325)	(2,754)	(2,070)
Cash paid for fractional shares	(21)	(32)	
Net cash (used in) provided by financing activities	(17,846)	30,828	31,096
(Decrease) increase in cash and cash equivalents	(10,723)	960	5,318
Cash and cash equivalents at beginning of year	36,075	35,115	29,797
Cash and cash equivalents at end of year	\$ 25,352	\$ 36,075	\$ 35,115
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 10,815	\$ 6,509	\$ 3,149
Income taxes	\$ 6,665	\$ 5,990	\$ 1,765
Non-cash investing activities:			
Net change in unrealized loss (gain) on available-for-sale investment securities	\$ 322	\$ (2,159)	\$ (550)
Non-cash financing activities:			
Dividends declared and unpaid	\$ 848	\$ 841	\$ 582
Adjustments to goodwill		\$ 238	
Cumulative effect of adopting SAB 108, net of taxes	\$ 214		
Supplemental schedule related to acquisition (Notes 3 and 4):			
Deposits			\$ 119,236
Other liabilities			489
Payable to Bank of Amador shareholders			12,730
Interest bearing deposits in banks			(100)
Available-for-sale investment securities			(22,542)
Loans, net			(78,737)
Premise and equipment			(226)
Intangible assets			(18,296)
Other assets			(4,544)
Stock issued			18,284
Cash acquired			\$ 26,294

The accompanying notes are an integral part of these consolidated financial statements.

American River Bankshares and Subsidiaries Consolidated Statement of Cash Flow (Continued)

## Notes To Consolidated Financial Statements

### **Note 1** The Business Of The Company

American River Bankshares (the "Company") was incorporated under the laws of the State of California in 1995 under the name of American River Holdings and changed its name in 2004 to American River Bankshares. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. As a community oriented bank holding company, the principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Amador, and Sonoma counties.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank (ARB). ARB was incorporated in 1983. ARB accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. ARB operates six banking offices in Sacramento and Placer counties, three banking offices in Sonoma County under the name North Coast Bank (NCB), a division of ARB, and three banking offices in Amador County under the name Bank of Amador, a division of ARB.

On December 3, 2004, the Company acquired Bank of Amador located in Jackson, California (more fully described in Note 3). Bank of Amador was merged with and into ARB and now operates as Bank of Amador, a division of ARB. The merger transaction was accounted under the purchase method of accounting and accordingly the results of their operations have been included in the consolidated financial statements since the date of acquisition.

The Company also owns one inactive subsidiary, American River Financial.

The deposits of ARB are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to applicable legal limits. ARB does not offer trust services or international banking services and does not plan to do so in the near future.

### **Note 2** Summary Of Significant Accounting Policies

#### General

The accounting and reporting policies of the Company and its subsidiaries conform with accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry.

#### Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2006.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and accounts have been eliminated in consolidation.

#### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one-day periods.

## **Note 2** Summary Of Significant Accounting Policies *(Continued)*

### **Investment Securities**

Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums. In addition, unrealized losses that are other than temporary are recognized in earnings for all investments.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

### **Federal Home Loan Bank Stock**

Investments in Federal Home Loan Bank (FHLB) stock are carried at cost and are redeemable at par with certain restrictions. Investments in FHLB stock are necessary to participate in FHLB programs.

### **Loans and Leases**

Loans and leases are reported at the principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs and the allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to the yield of the related loans and leases.

The accrual of interest on loans and leases is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the loan or lease is well secured and in the process of collection. Interest received on nonaccrual loans and leases is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

**Note 2** Summary Of Significant Accounting Policies (Continued)**Loan Sales and Servicing**

Included in the portfolio are Small Business Administration (SBA) loans and Farmer Mac guaranteed loans that may be sold in the secondary market. At the time the loan is sold, the related right to service the loan is either retained, with the Company earning future servicing income, or released in exchange for a one-time servicing-released premium. A portion of this premium may be required to be refunded if the borrower defaults or the loan prepays within ninety days of the settlement date. There were no sales of loans subject to these recourse provisions at December 31, 2006, 2005 and 2004. Loans subsequently transferred to the loan portfolio are transferred at the lower of cost or market value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method. There were no loans held for sale at December 31, 2006 and 2005.

SBA and Farmer Mac loans with unpaid balances of \$1,218,000 and \$1,609,000 were being serviced for others as of December 31, 2006 and 2005, respectively. The Company also serviced loans that are participated with other financial institutions totaling \$11,642,000 and \$20,911,000 as of December 31, 2006 and 2005, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at the difference between the contractual servicing fees and adequate compensation for performing the servicing, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Servicing assets were not considered material for disclosure purposes.

**Allowance for Loan and Lease Losses**

The allowance for loan and lease losses is maintained to provide for probable losses related to impaired loans and leases and other probable losses on loans and leases identified by management as doubtful, substandard and special mention, as well as losses that can be expected to occur in the normal course of business related to currently performing loans and leases. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan and lease portfolio including concentrations, types of lending, specifically identified problem loans and leases, inherent risk of loss in the portfolio taken as a whole and economic conditions in the Company's service areas.

The methodology for evaluating the adequacy of the allowance for loan and lease losses has two basic elements: first, the identification of impaired loans and the measurement of impairment for each individual loan identified; and second, a method for estimating a general allowance for loan and lease losses.

A loan or lease is considered impaired when it is probable that all contractual principal and interest payments due will not be collected in accordance with the terms of the loan or lease agreement. Impairment on individually identified loans or leases that are not collateral dependent is measured based on the present value of expected future cash flows discounted at each loan or lease's original effective interest rate. For loans that are collateral dependent, impairment is measured based on the fair value of the collateral less estimated selling costs.

In estimating the general allowance for loan and lease losses, the balance of the loan portfolio is grouped into segments that have common characteristics, such as loan type, collateral type or risk rating. Loans typically segregated by risk rating are those that have been assigned ratings (using regulatory definitions) of special mention, substandard and doubtful. Loans graded loss are generally charged off immediately.

For each general allowance portfolio segment, loss factors are applied to calculate the required allowance. These loss factors are based upon historical loss rates adjusted for qualitative factors representing other significant factors affecting loan portfolio including economic factors, credit policy and underwriting, management and staff effectiveness, trends in delinquencies and losses, and concentrations.

The Company's Loan Committee reviews the adequacy of the allowance for loan and lease losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance is adjusted based on that review if, in the judgment of the Loan Committee and management, changes are warranted.

## **Note 2** Summary Of Significant Accounting Policies *(Continued)*

### **Allowance for Loan and Lease Losses** *(Continued)*

The allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan and lease growth. Though management believes the allowance for loan and lease losses to be adequate, ultimate losses may vary from their estimates. In addition, the Federal Reserve Bank and California Department of Financial Institutions, as an integral part of their examination process, review the allowance for loan and lease losses. These agencies may require additions to the allowance for loan and lease losses based on their judgment about information available at the time of their examinations.

### **Other Real Estate**

Other real estate includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property less estimated selling costs is charged against the allowance for loan and lease losses. A valuation allowance for losses on other real estate is maintained to provide for temporary declines in value. The allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or writedowns resulting from permanent impairments are recorded in other income or expense as incurred. There was no other real estate held by the Company at December 31, 2006 and 2005.

### **Premises and Equipment**

Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful life of the building and improvements is forty years. The useful lives of furniture, fixtures and equipment are estimated to be three to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Impairment of long-lived assets is evaluated by management based upon an event or changes in circumstances surrounding the underlying assets which indicate long-lived assets may be impaired.

### **Goodwill and Intangible Assets**

Business combinations involving the Company's acquisition of equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at least annually.

Intangible assets are comprised of core deposit intangibles which represent the estimated fair value of the long-term deposit relationships that were assumed when the Company acquired Bank of Amador. Core deposit intangibles are amortized using a method that approximates the expected run-off of the deposit base, which, in this case, is eight years. Management evaluates the recoverability and remaining useful life annually to determine whether events or circumstances warrant a revision to the intangible assets or the remaining amortization period.

### **Income Taxes**

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

**Note 2 Summary Of Significant Accounting Policies (Continued)****Comprehensive Income**

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income (loss), adjusted for realized gains or losses included in net income. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statement of changes in shareholders' equity.

**Earnings Per Share**

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted EPS. EPS is retroactively adjusted for stock splits and stock dividends for all periods presented.

**Stock-Based Compensation**

At December 31, 2006, the Company has two stock-based compensation plans, which are described more fully in Note 13. Prior to January 1, 2006, the Company accounted for the plans under the recognition and measurement provisions of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by Financial Accounting Standards Board ("FASB") Statement No. 123, *Accounting for Stock-Based Compensation*, and FASB Statement No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. No stock-based employee compensation cost was recognized for options granted for the years ended December 31, 2005 and 2004 in the consolidated statement of income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under that transition method, compensation cost recognized in fiscal year 2006 includes: (a) compensation cost for all share-based payments vesting during 2006 that were granted prior to, but not yet vested as of January 1, 2006 based on the grant-date fair value estimated in accordance with the original provisions of Statement No. 123, and (b) compensation cost for all share-based payments vesting during 2006 that were granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement No. 123(R). Results for prior periods have not been restated and there was no one-time effect resulting from the adoption of FASB Statement No. 123(R). Compensation expense, net of related tax benefits, recorded in 2006 as a result of applying this accounting standard totaled \$184,000, or \$.03 per diluted share. Compensation expense is recognized over the vesting period on a straight line accounting basis.

The Company followed the alternative transition method allowed under FAS 123R-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* ("FSP 123R-3") which provides for a simplified method to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee share-based compensation.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of FASB Statement No. 123 to stock-based compensation for the years ended December 31, 2005 and 2004. Pro forma adjustments to the Company's consolidated net income and earnings per share are disclosed during the years in which the options become vested (dollars in thousands, except per share data).

**Note 2** Summary Of Significant Accounting Policies (Continued)

## Stock-Based Compensation (Continued)

Year Ended December 31, (Dollars in thousands, except per share data)	2005	2004
Net income, as reported	\$ 9,184	\$ 5,827
Add: Stock-based compensation expense included in reported net income, net of tax effect		
Deduct: Total stock-based compensation expensedetermined under the fair value based method for all awards, net of related tax effects	(88)	(68)
Pro forma net income	\$ 9,096	\$ 5,759
Basic earnings per share - as reported	\$ 1.56	\$ 1.18
Basic earnings per share - pro forma	\$ 1.54	\$ 1.16
Diluted earnings per share - as reported	\$ 1.53	\$ 1.13
Diluted earnings per share - pro forma	\$ 1.53	\$ 1.13

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton based option valuation model that uses the assumptions noted in the following table. Because Black-Scholes-Merton based option valuation models incorporate ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination with the valuation model. The expected term of options granted is derived from guidance provided in the Securities and Exchange Commissions' Staff Accounting Bulletin No. 107 and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2006	2005	2004
Dividend yield	2.16%	2.27% to 2.71%	2.15%
Expected volatility	29.6%	30.3% to 31.4%	22.0%
Risk-free interest rate	4.68%	3.96% to 4.08%	4.01%
Expected option life in years	7	7	7
Weighted average fair value of options granted during the year	\$8.34	\$5.92	\$4.47

The following is a summary of stock option information as of or for the year ended December 31, 2006, 2005 and 2004:

(Dollars in thousands)	2006	2005	2004
Total intrinsic value of options exercised	\$ 791	\$ 2,062	\$ 4,237
Aggregate cash received for option exercises	\$ 292	\$ 476	\$ 1,183
Total compensation cost (included in noninterest expense)	\$ 221		
Tax benefit recognized	\$ 37		
Net compensation cost	\$ 184		
Total compensation cost for nonvested awards not yet recognized	\$ 828		
Weighted average years to be recognized	2.4		

## Cumulative Effect of Adopting Staff Accounting Bulletin No. 108

In September 2006, the SEC ("SEC") issued Staff Accounting Bulletin ("SAB") No. 108 *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on how registrants should quantify financial statement misstatements. Under SAB 108 registrants are required to consider both a "rollover" method which focuses primarily on the income statement impact of misstatements and the "iron curtain" method which focuses primarily on the balance sheet impact of misstatements. The transition provisions of SAB 108 permit a registrant to adjust retained earnings for the cumulative effect of immaterial errors relating to prior years. The Company was required to adopt SAB 108 in the fourth quarter of 2006.

**Note 2 Summary Of Significant Accounting Policies (Continued)****Cumulative Effect of Adopting Staff Accounting Bulletin No. 108 (Continued)**

Historically, the Company evaluated uncorrected differences utilizing the rollover approach. Management believes that the impact of errors related to unrecorded compensated absences was immaterial to prior fiscal years under the rollover method. Under SAB 108 management must assess materiality using both the rollover method and the iron-curtain method. Under the iron-curtain method, the cumulative effect of unrecorded compensated absences is material to the Company's 2006 financial statements and, therefore, management has recorded an adjustment to decrease the opening 2006 retained earnings balance in the amount of \$214,000, increase other liabilities in the amount of \$350,000 and increase deferred tax assets by \$136,000 in accordance with the implementation guidance in SAB 108.

**Impact of New Financial Accounting Standards*****Accounting for Uncertainty in Income Taxes***

In July 2006, the FASB issued Financial Accounting Standards Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company presently recognizes income tax positions based on management's estimate of whether it is reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*.

The provisions of FIN 48 will be effective for the Company on January 1, 2007 and are to be applied to all tax positions upon initial application of this standard. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption.

The cumulative effect of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of retained earnings for the fiscal year of adoption. Management does not expect the adoption of FIN 48 to have a material impact on the Company's financial position or results of operations.

***Fair Value Measurements***

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. Management is in the process of evaluating the impact of adopting this statement.

**Note 3 Merger Transaction With Bank Of Amador**

On December 3, 2004, the Company completed an acquisition of Bank of Amador (BNKA) through a merger and tax-free reorganization. The Company acquired BNKA and merged BNKA with and into ARB. The acquisition was completed because the Board of Directors and management of both organizations believed the combination would be in the best interests of shareholders of the Company and BNKA and that the combined companies could offer a broader array of services and products than each could offer on its own. Total consideration paid BNKA shareholders was determined through extensive negotiations supported by internal modeling, which management believed would result in earnings per share accretion to the Company's shareholders in 2005. These factors contributed to the purchase price which resulted in the recognition of goodwill.



### Note 3 Merger Transaction With Bank Of Amador (Continued)

The following table summarizes the terms of the acquisition (dollars in thousands):

Shares of common stock issued	775,548
Value of common stock issued	\$ 18,284
Cash paid to Bank of Amador shareholders	\$ 12,730
Total consideration paid	\$ 31,014

During 2005, goodwill was increased \$238,000 representing the final adjustments to the initial allocation of the purchase price.

The following supplemental pro forma information discloses selected financial information for the year ended December 31, 2004 as though the merger had been completed at the beginning of the year (dollars in thousands, except per share data):

Earnings as reported:

Revenue	\$ 25,031
Net income	\$ 5,827
Basic EPS	\$ 1.30
Diluted EPS	\$ 1.24

Pro forma merger adjustments:

Revenue	\$ 6,905
Net income	\$ 1,584

Pro forma earnings after merger adjustments:

Revenue	\$ 31,936
Net income	\$ 7,411
Basic EPS	\$ 1.42
Diluted EPS	\$ 1.37

Pro forma net income for the year ended December 31, 2004 excludes nonrecurring charges of approximately \$2,086,000 on an after-tax basis, representing merger-related expenses and the cost of retiring outstanding stock options.

The estimated fair value of assets acquired and liabilities assumed at December 3, 2004 are as follows (dollars in thousands):

Cash and cash equivalents	\$ 26,294
Interest-bearing deposits in banks	100
Available-for-sale investment securities	22,542
Gross loans	79,598
Allowance for loan and lease losses	(861)
Premises and equipment	226
Core deposit intangible	2,213
Goodwill	16,083
Other assets	4,544
Total assets acquired	150,739
Deposits	119,236
Other liabilities	489
Total liabilities assumed	119,725
Purchase price	\$ 31,014

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 4 Goodwill And Other Intangible Assets**

At December 31, 2006 and 2005, goodwill totaled \$16,321,000. Goodwill is evaluated annually for impairment under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, and management determined that no impairment recognition was required for the years ended December 31, 2006 and 2005. Goodwill is not deductible for tax purposes.

Other intangible assets are comprised of core deposit intangibles totaling \$1,501,000 and \$1,831,000 at December 31, 2006 and 2005, respectively. Amortization included in other expense totaled \$330,000 and \$352,000 for the years ended December 31, 2006 and 2005, respectively. The remaining balance will be amortized over 5.9 years. Amortization expense for the next five years is estimated as follows (*dollars in thousands*):

Year Ending December 31,	
2007	\$ 308
2008	286
2009	264
2010	242
2011	219

**Note 5 Investment Securities**

The amortized cost and estimated fair value of investment securities at December 31, 2006 and 2005 consisted of the following (*dollars in thousands*):

## Available-for-Sale

	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 28,532	\$ (409)	\$ 28,123	
Mortgage-backed securities	33,930	9	(703)	33,236
Obligations of states and political subdivisions	41,115	407	(298)	41,224
Corporate debt securities	1,005	(2)	1,003	
Equity securities:				
Corporate stock	584	50	(11)	623
	<u>\$ 105,166</u>	<u>\$ 466</u>	<u>\$ (1,423)</u>	<u>\$ 104,209</u>
	2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 49,860	\$ (741)	\$ 49,119	
Mortgage-backed securities	37,065	31	(770)	36,326
Obligations of states and political subdivisions	36,942	486	(322)	37,106
Corporate debt securities	1,017	(3)	1,014	
Equity securities:				
Corporate stock	584	52	(12)	624
	<u>\$ 125,468</u>	<u>\$ 569</u>	<u>\$ (1,848)</u>	<u>\$ 124,189</u>

## Note 5 Investment Securities (Continued)

Net unrealized losses on available-for-sale investment securities totaling \$957,000 were recorded, net of \$392,000 in tax benefits, as accumulated other comprehensive loss within shareholders' equity at December 31, 2006. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2006 totaled \$3,259,000 and \$1,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2006.

Net unrealized losses on available-for-sale investment securities totaling \$1,279,000 were recorded, net of \$522,000 in tax benefits, as accumulated other comprehensive loss within shareholders' equity at December 31, 2005. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2005 totaled \$6,964,000 and \$48,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2005.

Proceeds and gross realized losses from the sale of available-for-sale investment securities for the year ended December 31, 2004 totaled \$5,019,000 and \$38,000, respectively.

### Held-to-Maturity

		2006			
		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:					
Mortgage-backed securities		\$ 44,031	\$ 69	\$ (380)	\$ 43,720
		2005			
		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:					
Mortgage-backed securities		\$ 45,012	\$ 60	\$ (414)	\$ 44,658

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2006, 2005 and 2004.

The amortized cost and estimated fair value of investment securities at December 31, 2006 by contractual maturity are shown below (*dollars in thousands*).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Gross Unrealized Gains	Amortized Cost	Estimated Fair Value
Within one year	\$ 17,505	\$ 17,428		
After one year through five years	29,374	28,877		
After five years through ten years	13,535	13,791		
After ten years	10,238	10,254		
	70,652	70,350		
Investment securities not due at a single maturity date:				
Mortgage-backed securities	33,930	33,236	\$ 44,031	\$ 43,720
Corporate stock	584	623		
	\$ 105,166	\$ 104,209	\$ 44,031	\$ 43,720

**Note 5 Investment Securities (Continued)**

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment securities with amortized costs totaling \$62,347,000 and \$57,898,000 and estimated fair values totaling \$61,240,000 and \$56,901,000 were pledged to secure treasury tax and loan accounts, State Treasury funds on deposit, public agency and bankruptcy trustee deposits and borrowing arrangements (see Note 10) at December 31, 2006 and 2005, respectively.

Investment securities with unrealized losses at December 31, 2006 and 2005 are summarized and classified according to the duration of the loss period as follows (*dollars in thousands*):

		2006					
		Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale							
Debt securities:							
U.S. Government agencies				\$ 28,123	\$ (409)	\$ 28,123	\$ (409)
Mortgage-backed securities				32,150	(703)	32,150	(703)
Obligations of states and political sub-divisions		\$ 7,285	\$ (50)	16,650	(247)	23,935	(297)
Corporate debt securities				1,003	(2)	1,003	(2)
Corporate stock				239	(12)	239	(12)
		\$ 7,285	\$ (50)	\$ 78,165	\$ (1,373)	\$ 85,450	\$ (1,423)

**Held-to-Maturity**

Debt securities:					
Mortgage-backed securities	\$ 2,250	\$ (7)	\$ 29,672	\$ (373)	\$ 31,922
					\$ (380)

		2005					
		Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale							
Debt securities:							
U.S. Government agencies	\$ 29,344	\$ (368)	\$ 19,775	\$ (373)	\$ 49,119	\$ (741)	
Mortgage-backed securities	16,779	(374)	16,619	(396)	33,398	(770)	
Obligations of states and political sub-divisions	18,083	(212)	6,370	(110)	24,453	(322)	
Corporate debt securities	1,014	(3)	1,014	(3)			
Corporate stock	238	(12)	238	(12)			
	\$ 65,220	\$ (957)	\$ 43,002	\$ (891)	\$ 108,222	\$ (1,848)	

**Held-to-Maturity**

Debt securities:					
Mortgage-backed securities	\$ 30,753	\$ (344)	\$ 3,130	\$ (70)	\$ 33,883
					\$ (414)

## Note 5 Investment Securities (Continued)

At December 31, 2006, the unrealized loss on the Company's investments in U.S. Government agencies, mortgage-backed securities and obligations of states and political sub-divisions is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity, management does not consider these investments to be other-than-temporarily impaired.

At December 31, 2006, the unrealized loss on the Company's investments in corporate debt securities is related to two investments that are in a loss position of \$2,000 that have been evaluated by management for other-than-temporary impairment. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities; therefore, management does not consider these investments to be other-than-temporarily impaired.

At December 31, 2006, the unrealized loss on the Company's investments in corporate stock is related to a single investment that is in a loss position of \$12,000 that has been evaluated by management for other-than-temporary impairment. The Company has the ability and intent to hold this investment until recovery of fair value; therefore, management does not consider this investment to be other-than-temporarily impaired.

## Note 6 Loans And Leases

Outstanding loans and leases are summarized as follows (dollars in thousands):

	December 31,	
	2006	2005
Real estate - commercial	\$ 175,643	\$ 154,500
Real estate - construction	90,314	103,048
Real estate - multi-family	3,618	3,767
Real estate - residential	8,689	4,680
Commercial	85,859	77,971
Lease financing receivable	6,375	7,967
Agriculture	7,362	8,129
Consumer	11,712	11,900
	389,572	371,962
Deferred loan and lease origination fees, net	(705)	(712)
Allowance for loan and lease losses	(5,874)	(5,679)
	<u>\$ 382,993</u>	<u>\$ 365,571</u>

Certain loans have been pledged to secure borrowing arrangements (see Note 10).

The components of the Company's leases receivable are summarized as follows (dollars in thousands):

	December 31,	
	2006	2005
Future lease payments receivable	\$ 6,883	\$ 8,470
Residual interests	226	275
Unearned income	(734)	(778)
Net lease financing receivable	<u>\$ 6,375</u>	<u>\$ 7,967</u>

**Note 6 Loans And Leases (Continued)**

Future lease payments receivable are as follows (dollars in thousands):

<u>Year Ending December 31,</u>	
2007	\$ 2,984
2008	2,059
2009	975
2010	461
2011	216
Thereafter	<u>188</u>
Total lease payments receivable	<u>\$ 6,883</u>

Changes in the allowance for loan and lease losses were as follows (dollars in thousands):

	<u>Year Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance, beginning of year	\$ 5,679	\$ 5,496	\$ 3,949
Allowance acquired			861
Provision charged to operations	320	322	895
Losses charged to allowance	(150)	(206)	(269)
Recoveries	25	67	60
Balance, end of year	<u>\$ 5,874</u>	<u>\$ 5,679</u>	<u>\$ 5,496</u>

At December 31, 2006 and 2005, nonaccrual loans and leases totaled \$65,000 and \$67,000, respectively. Interest foregone on nonaccrual loans for the years ended December 31, 2006, 2005 and 2004 was not material. There were no impaired loans at December 31, 2006 and 2005.

Salaries and employee benefits totaling \$1,183,000, \$1,395,000 and \$706,000 have been deferred as loan and lease origination costs for the years ended December 31, 2006, 2005 and 2004, respectively.

**Note 7 Premises And Equipment**

Premises and equipment consisted of the following (dollars in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Land	\$ 206	\$ 206
Building and improvements	873	779
Furniture, fixtures and equipment	6,267	6,023
Leasehold improvements	<u>1,141</u>	<u>1,133</u>
	8,487	8,141
Less accumulated depreciation and amortization	<u>(6,641)</u>	<u>(6,051)</u>
	<u>\$ 1,846</u>	<u>\$ 2,090</u>

Depreciation and amortization included in occupancy and furniture and equipment expense totaled \$623,000, \$672,000 and \$562,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

## Note 8 Accounts Receivable Servicing Receivables

The Company purchases existing accounts receivable on a discounted basis from selected merchants and assumes the related billing and collection responsibilities on a recourse basis. Accounts receivable servicing fees included in other income totaled \$372,000, \$356,000 and \$316,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The valuation allowance for these receivables is not significant.

## Note 9 Interest-Bearing Deposits

Interest-bearing deposits consisted of the following (dollars in thousands):

	December 31,	
	2006	2005
Savings	\$ 36,893	\$ 37,711
Money market	122,765	133,443
NOW accounts	41,814	46,364
Time, \$100,000 or more	82,569	69,063
Other time	49,260	49,728
	<u>\$ 333,301</u>	<u>\$ 336,309</u>

Aggregate annual maturities of time deposits are as follows (dollars in thousands):

Year Ending December 31,	
2007	\$ 113,633
2008	6,736
2009	4,489
2010	1,770
2011	5,184
Thereafter	17
	<u>\$ 131,829</u>

Interest expense recognized on interest-bearing deposits consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2006	2005	2004
Savings	\$ 242	\$ 150	\$ 56
Money market	3,074	2,164	1,057
NOW accounts	130	83	43
Time, \$100,000 or more	3,092	1,620	836
Other time	2,139	1,629	519
	<u>\$ 8,677</u>	<u>\$ 5,646</u>	<u>\$ 2,511</u>

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 10** Borrowing Arrangements

The Company has a total of \$53,000,000 in unsecured short-term borrowing arrangements to purchase Federal funds with four of its correspondent banks. There were no advances under the borrowing arrangements as of December 31, 2006 and 2005.

In addition, the Company has a line of credit available with the Federal Home Loan Bank which is secured by pledged mortgage loans (see Note 6) and investment securities (see Note 5). Borrowings may include overnight advances as well as loans with a term of up to thirty years. Advances totaling \$42,270,000 were outstanding from the Federal Home Loan Bank at December 31, 2006, bearing fixed interest rates ranging from 2.66% to 6.13% and maturing between January 3, 2007 and April 7, 2008. Advances totaling \$43,656,000 were outstanding from the Federal Home Loan Bank at December 31, 2005, bearing fixed interest rates ranging from 2.10% to 6.13% and maturing between January 3, 2006 and December 31, 2007. Amounts available under the borrowing arrangement with the Federal Home Loan Bank at December 31, 2006 and 2005 totaled \$87,091,000 and \$3,534,000, respectively.

The following table summarizes these borrowings (*in thousands*):

	December 31,			
	2006		2005	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Short-term portion of borrowings	\$ 37,270	5.08%	\$ 39,386	3.73%
Long-term borrowings	5,000	4.92%	4,270	4.10%
	<u>\$ 42,270</u>	5.06%	<u>\$ 43,656</u>	3.76%

Future minimum principal payments on outstanding borrowings are as follows (*dollars in thousands*):

<u>Year Ending December 31,</u>	
2007	\$ 37,270
2008	5,000
	<u>\$ 42,270</u>

The Company has also been issued \$3,500,000 in letters of credit by the Federal Home Loan Bank which have been pledged to secure Local Agency Deposits. The letters of credit act as a guarantee of payment to certain third parties in accordance with specified terms and conditions. The letters of credit were not drawn upon in 2006 and management does not expect to draw upon these lines in the future.



## Note 11 Income Taxes

The provision for income taxes for the years ended December 31, 2006, 2005, and 2004 consisted of the following (dollars in thousands):

	Federal	State	Total
2006			
Current	\$ 5,076	\$ 1,666	\$ 6,742
Deferred	(878)	(125)	(1,003)
Provision for income taxes	\$ 4,198	\$ 1,541	\$ 5,739
2005			
Current	\$ 4,706	\$ 1,508	\$ 6,214
Deferred	(481)	59	(422)
Provision for income taxes	\$ 4,225	\$ 1,567	\$ 5,792
2004			
Current	\$ 2,504	\$ 956	\$ 3,460
Deferred	(25)	(57)	(82)
Provision for income taxes	\$ 2,479	\$ 899	\$ 3,378

Deferred tax assets (liabilities) consisted of the following (dollars in thousands):

	December 31,	
	2006	2005
Deferred tax assets:		
Allowance for loan and lease losses	\$ 2,532	\$ 2,382
Future benefit of State tax deduction	580	506
Deferred compensation	1,172	517
Unrealized losses on available-for-sale investment securities	409	522
Other	237	167
Total deferred tax assets	4,930	4,094
Deferred tax liabilities:		
Core deposit intangible	(682)	(819)
Investment market to market	(129)	(165)
Future liability of State deferred tax assets	(215)	(133)
Deferred loan costs	(438)	(430)
Federal Home Loan Bank stock dividends	(161)	(122)
Other		(10)
Total deferred tax liabilities	(1,625)	(1,679)
Net deferred tax assets	\$ 3,305	\$ 2,415

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 11 Income Taxes (Continued)**

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate of 35.0% to income before income taxes. The significant items comprising these differences consisted of the following:

	Year Ended December 31,		
	2006	2005	2004
Federal income tax statutory rate	35.0 %	34.0 %	34.0 %
State franchise tax, net of Federal tax effect	6.8 %	6.9 %	6.4 %
Tax benefit of interest on obligations of states and political subdivisions	(2.2)%	(2.0)%	(1.9)%
Tax-exempt income from life insurance policies	(0.5)%	(0.4)%	(2.3)%
Stock option compensation expense	0.3 %		
Other	(0.6)%	0.2 %	0.5 %
Effective tax rate	38.8 %	38.7 %	36.7 %

**Note 12 Commitments And Contingencies****Leases**

The Company leases branch facilities, administrative offices and various equipment under noncancelable operating leases which expire on various dates through the year 2016. Certain of the leases have five year renewal options. Two of the branch facilities are leased from current or former members of the Company's Board of Directors (see Note 17).

Future minimum lease payments are as follows (*dollars in thousands*):

Year Ending December 31,	
2007	\$ 977
2008	1,084
2009	833
2010	653
2011	555
Thereafter	1,563
	<u>\$ 5,665</u>

Rental expense included in occupancy, furniture and equipment expense totaled \$1,035,000, \$887,000 and \$718,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**Financial Instruments With Off-Balance-Sheet Risk**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the consolidated balance sheet.

## Note 12 Commitments And Contingencies (Continued)

### Financial Instruments With Off-Balance-Sheet Risk (Continued)

The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	December 31,	
	2006	2005
Commitments to extend credit:		
Revolving lines of credit secured by 1-4 family residences	\$ 9,144	\$ 16,842
Commercial real estate, construction and land development commitments secured by real estate	45,752	55,313
Other unused commitments, principally commercial loans	59,686	65,644
	<u>\$ 114,582</u>	<u>\$ 137,802</u>
Standby letters of credit	<u>\$ 5,701</u>	<u>\$ 3,393</u>

Real estate commitments are generally secured by property with a loan-to-value ratio of 65% to 75%. In addition, the majority of the Company's commitments have variable interest rates.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each client's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, equipment and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance or financial obligation of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2006 and 2005. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

### Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial, agricultural and consumer loans to clients throughout Sacramento, Placer, Yolo, Amador, El Dorado, Sonoma, Napa, Marin and Mendocino counties.

In management's judgment, a concentration exists in real estate-related loans which represented approximately 71% and 72% of the Company's loan portfolio at December 31, 2006 and 2005, respectively. Although management believes such concentrations to have no more than the normal risk of collectibility, a substantial decline in the economy in general, or a decline in real estate values in the Company's primary market areas in particular, could have an adverse impact on collectibility of these loans. However, personal and business income represent the primary source of repayment for a majority of these loans.

### Correspondent Banking Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Uninsured deposits totaled \$2,601,000 at December 31, 2006.

### Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

**Note 13 Shareholders' Equity****Earnings Per Share**

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations is as follows (dollars and shares in thousands, except per share data):

For the Year Ended	Net	Weighted Average Number of Shares Outstanding	Per-Share Amount
<u>December 31, 2006</u>	Income		
Basic earnings per share	\$ 9,062	5,801	\$ 1.56
Effect of dilutive stock options		107	
Diluted earnings per share	\$ 9,062	5,908	\$ 1.53
<u>December 31, 2005</u>			
Basic earnings per share	\$ 9,184	5,901	\$ 1.56
Effect of dilutive stock options		121	
Diluted earnings per share	\$ 9,184	6,022	\$ 1.53
<u>December 31, 2004</u>			
Basic earnings per share	\$ 5,827	4,952	\$ 1.18
Effect of dilutive stock options		226	
Diluted earnings per share	\$ 5,827	5,178	\$ 1.13

**Stock Option Plans**

In 2000 and 1995, the Board of Directors adopted stock option plans under which options may be granted to employees and directors under incentive and nonstatutory agreements. Both of these plans have been approved by the Company's shareholders. At December 31, 2006, grants outstanding combined with shares available for future grants totaled 637,040 shares under these plans. The plans require that the option price may not be less than the fair market value of the stock at the date the option is granted. The purchase price of exercised options is payable in full in cash or shares of the Company's common stock owned by the optionee at the time the option is exercised. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. Options vest ratably over a five year period. Outstanding options under the 1995 plan are exercisable until their expiration; however, no new options will be granted under this plan. The Plans do not provide for the settlement of awards in cash and new shares are issued upon the exercise of options.

**Note 13 Shareholders' Equity (Continued)****Stock Option Plans (Continued)**

A summary of the outstanding and vested stock option activity for the year ended December 31, 2006 is as follows:

	Outstanding		Nonvested	
	Shares	Weighted Average Exercise Price Per Share	Shares	Weighted Average Fair Value Per Share
Balance, January 1, 2006	303,812	\$ 12.59	136,446	\$ 4.88
Options granted	67,926	\$ 26.48	67,926	\$ 8.34
Options vested			(33,037)	\$ 4.65
Options exercised	(45,070)	\$ 6.48		
Options expired or canceled	(386)	\$ 19.44		
Balance, December 31, 2006	326,282	\$ 16.32	171,335	\$ 6.29

A summary of exercisable options as of December 31, 2006 is as follows:

Number of vested stock options	154,947
Weighted average exercise price per share	\$ 10.54
Aggregate intrinsic value	\$2,085,000
Weighted average remaining contractual term in years	4.0

A summary of options outstanding at December 31, 2006 follows:

Range of Exercise Prices	Number of Options Outstanding December 31, Income	Weighted Average Remaining Contractual Outstanding	Number of Options Exercisable December 31 Amount
\$ 4.51	16,372	3.05 years	16,372
\$ 4.78	11,807	1.75 years	11,807
\$ 5.30	12,287	.35 years	12,287
\$ 7.65	10,440	2.85 years	10,440
\$ 7.82	9,212	2.05 years	9,212
\$ 8.43	35,323	1.75 years	35,323
\$ 12.87	40,235	6.25 years	23,332
\$ 13.95	841	6.45 years	505
\$ 18.50	56,922	7.35 years	22,686
\$ 19.96	26,516	8.05 years	5,303
\$ 20.10	38,401	8.65 years	7,680
\$ 26.48	67,926	9.15 years	
	326,282		154,947

**Common Stock Repurchase Program**

On September 20, 2001, the Board of Directors of the Company authorized a stock repurchase program which calls for the repurchase of up to five percent (5%) annually of the Company's outstanding shares of common stock. The repurchases are to be made from time to time in the open market as conditions allow. The Board of Directors has reserved the right to suspend, terminate, modify or cancel this repurchase program at any time for any reason.

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 13 Shareholders' Equity (Continued)****Stock Dividend**

The Board of Directors declared 5% stock dividends on November 15, 2006, November 16, 2005 and December 16, 2004. All per share and stock option data included in the consolidated financial statements have been retroactively restated to reflect the stock dividends.

**Note 14 Regulatory Matters****Dividends**

Upon declaration by the Board of Directors of the Company, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. In addition, subject to prior regulatory approval, any state banking association may request an exception to this restriction. In 2006, ARB requested, and received approval for, a one-time payment of \$2,500,000. At December 31, 2006, ARB had \$223,000 in retained earnings available for dividend payments to the Company.

The Company has paid quarterly cash dividends on its common stock since the first quarter of 2004; prior to that, the Company paid cash dividends twice a year since 1992. It is currently the intention of the Board of Directors of the Company to continue payment of cash dividends on a quarterly basis. In 2006, 2005 and 2004, the Company declared cash dividends in the amount of \$.58, \$.51 and \$.40, respectively, per common share. The amounts have been adjusted to reflect 5% stock dividends declared in 2006 and in 2005. There is no assurance, however, that any dividends will be paid in the future since they are subject to regulatory restrictions, and dependent upon earnings, financial condition and capital requirements of the Company and its subsidiaries.

**Regulatory Capital**

The Company and ARB are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the banking subsidiaries must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and ARB's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking subsidiary to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Company and its banking subsidiary met all their capital adequacy requirements as of December 31, 2006 and 2005.

In addition, the most recent notifications from the FDIC categorized ARB as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, ARB must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below. There are no conditions or events since those notifications that management believes have changed the categories.

**Note 14 Regulatory Matters (Continued)****Regulatory Capital (Continued)***(dollars in thousands)***Leverage Ratio**

American River Bankshares and Subsidiaries  
Minimum regulatory requirement

December 31,			
2006		2005	
Amount	Ratio	Amount	Ratio

\$ 45,114 7.8% \$ 45,351 7.6%  
23,097 4.0% 23,741 4.0%

American River Bank  
Minimum requirement for "Well-Capitalized" institution  
Minimum regulatory requirement

45,842 8.0% 45,602 7.7%  
28,825 5.0% 29,620 5.0%  
23,060 4.0% 23,696 4.0%

**Tier 1 Risk-Based Capital Ratio**

American River Bankshares and Subsidiaries  
Minimum regulatory requirement

\$ 45,114 10.3% \$ 45,351 10.6%  
17,450 4.0% 17,165 4.0%

American River Bank  
Minimum requirement for "Well-Capitalized" institution  
Minimum regulatory requirement

45,842 10.5% 45,602 10.7%  
26,087 6.0% 25,680 6.0%  
17,391 4.0% 17,120 4.0%

**Total Risk-Based Capital Ratio**

American River Bankshares and Subsidiaries  
Minimum regulatory requirement

\$ 50,572 11.6% \$ 50,719 11.8%  
34,932 8.0% 34,355 8.0%

American River Bank  
Minimum requirement for "Well-Capitalized" institution  
Minimum regulatory requirement

51,282 11.8% 50,956 11.9%  
43,522 10.0% 42,833 10.0%  
34,818 8.0% 34,266 8.0%

**Note 15 Other Noninterest Income And Expense**Other noninterest income consisted of the following *(dollars in thousands)*:

	Year Ended December 31,		
	2006	2005	2004
Merchant fee income	\$ 549	\$ 509	\$ 393
Accounts receivable servicing fees (Note 8)	372	356	316
Income from residential lending division	256	283	187
Bank owned life insurance	192	179	69
Gain on life insurance death benefit			553
Other	290	282	326
	<u>\$ 1,659</u>	<u>\$ 1,609</u>	<u>\$ 1,844</u>

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 15 Other Noninterest Income And Expense (Continued)**

Other noninterest expense consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2006	2005	2004
Professional fees	\$ 778	\$ 732	\$ 478
Outsourced item processing	495	489	383
Telephone and postage	411	439	280
Advertising and promotion	357	331	288
Stationery and supplies	335	303	262
Amortization of intangible assets	330	352	30
Directors' expense	311	429	518
Donations	88	82	527
Other operating expenses	1,271	1,231	1,156
	<u>\$ 4,376</u>	<u>\$ 4,388</u>	<u>\$ 3,922</u>

**Note 16 Employee Benefit Plans****American River Bankshares 401(k) Plan**

The American River Bankshares 401(k) Plan commenced January 1, 1993 and is available to all employees. Under the plan, the Company will match 100% of each participants' contribution up to 3% of annual compensation plus 50% of the next 2% of annual compensation. Employer Safe Harbor matching contributions (made after January 1, 2004) are 100% vested upon entering the plan. The Company's contributions made prior to January 1, 2004 vest at a rate of 20% per year over a five year period. The Company's contributions totaled \$217,000, \$220,000 and \$169,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**Employee Stock Purchase Plan**

The Company contracts with an administrator for an Employee Stock Purchase Plan which allows employees to purchase the Company's stock at fair market value as of the date of purchase. The Company bears all costs of administering the Plan, including broker's fees, commissions, postage and other costs actually incurred.

**American River Bankshares Deferred Compensation Plan**

The Company has established a Deferred Compensation Plan for certain members of the management team and a Deferred Fee Agreement for Non-Employee Directors for the purpose of providing the opportunity for participants to defer compensation. Participants of the management team, who are selected by a committee designated by the Board of Directors, may elect to defer annually a minimum of \$5,000 or a maximum of eighty percent of their base salary and all of their cash bonus. Directors may also elect to defer up to one hundred percent of their monthly fees. The Company bears all administration costs and funds the interest earned on participant deferrals at a rate based on U.S. Government Treasury rates. Deferred compensation, including interest earned, totaled \$1,488,000, \$1,147,000 and \$851,000 at December 31, 2006, 2005 and 2004, respectively. The expense recognized under this plan totaled \$113,000, \$78,000 and \$55,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**Salary Continuation Plan**

The Company has agreements to provide certain current executives, or their designated beneficiaries, with annual benefits for up to 15 years after retirement or death. These benefits are substantially equivalent to those available under life insurance policies purchased by the Company on the lives of the executives. The Company accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. At the balance sheet date, the amount of accrued benefits approximates the then present value of the benefits expected to be provided at retirement. The expense recognized under this plan totaled \$126,000, \$115,000 and \$29,000 for the years ended December 31, 2006, 2005 and 2004, respectively.



**Note 16 Employee Benefit Plans (Continued)****Salary Continuation Plan (Continued)**

Under these plans, the Company invested in single premium life insurance policies with cash surrender values totaling \$9,697,000 and \$5,073,000 at December 31, 2006 and 2005, respectively. On the consolidated balance sheet, the cash surrender value of life insurance policies is included in accrued interest receivable and other assets. Tax-exempt income on these policies, net of expense, totaled approximately \$192,000, \$179,000 and \$69,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**Note 17 Related Party Transactions**

During the normal course of business, the Company enters into transactions with related parties, including Directors and affiliates. These transactions include borrowings from the Company with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2006 (*dollars in thousands*):

Balance, January 1, 2006	\$ 6,976
Disbursements	64
Amounts repaid	<u>4,801</u>
Balance, December 31, 2006	<u>\$ 2,239</u>
Undisbursed commitments to related parties, December 31, 2006	<u>\$ 106</u>

The Company also leases two of its branch facilities from current or former members of the Company's Board of Directors. Rental payments to the Directors totaled \$118,000, \$115,000 and \$112,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**Note 18 Other Comprehensive Income (Loss)**

At December 31, 2006, 2005 and 2004, the Company had other comprehensive income (loss) as follows

(*dollars in thousands*):

	Before Tax	Tax (Expense) Benefit	After Tax
<b>For the Year Ended December 31, 2006</b>			
Other comprehensive income:			
Unrealized holding gains	\$ 323	\$ (130)	\$ 193
Less reclassification adjustment for realized gains included in net income	1		1
	<u>\$ 322</u>	<u>\$ (130)</u>	<u>\$ 192</u>
<b>For the Year Ended December 31, 2005</b>			
Other comprehensive loss:			
Unrealized holding losses	\$ (2,111)	\$ 827	\$ (1,284)
Less reclassification adjustment for realized gains included in net income	48	(20)	28
	<u>\$ (2,159)</u>	<u>\$ 847</u>	<u>\$ (1,312)</u>
<b>For the Year Ended December 31, 2004</b>			
Other comprehensive loss:			
Unrealized holding losses	\$ (588)	\$ 256	\$ (332)
Less reclassification adjustment for realized losses included in net income	(38)	15	(23)
	<u>\$ (550)</u>	<u>\$ 241</u>	<u>\$ (309)</u>

**Note 19** Disclosures About Fair Value Of Financial Instruments

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments at December 31, 2006 and 2005:

**Cash and cash equivalents:** For cash and cash equivalents, the carrying amount is estimated to be fair value.

**Interest-bearing deposits in banks:** The fair values of interest-bearing deposits in banks are estimated by discounting their future cash flows using rates at each reporting date for instruments with similar remaining maturities offered by comparable financial institutions.

**Investment securities:** For investment securities, fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers.

**Loans and leases:** For variable-rate loans and leases that reprice frequently with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans and leases are estimated using discounted cash flow analyses, using interest rates being offered at each reporting date for loans and leases with similar terms to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

**FHLB stock:** The carrying amount of FHLB stock approximates its fair value. This investment is carried at cost and is redeemable at par with certain restrictions.

**Accounts receivable servicing receivables:** The carrying amount of accounts receivable servicing receivables approximates their fair value because of the relatively short period of time between the origination of the receivables and their expected collection.

**Cash surrender value of life insurance policies:** The fair value of life insurance policies are based on cash surrender values at each reporting date as provided by insurers.

**Deposits:** The fair values for demand deposits are, by definition, equal to the amount payable on demand at the reporting date represented by their carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis using interest rates offered at each reporting date for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

**Short-term and long-term borrowings:** The fair value of short-term borrowings is estimated to be the carrying amount. The fair value of long-term borrowings is estimated using a discounted cash flow analysis using interest rates currently available for similar debt instruments.

**Commitments to extend credit:** The fair value of commitments are based on fees currently charged to enter into similar agreements, net of origination fees. These fees were not material at December 31, 2006 and 2005.

**Note 19** Disclosures About Fair Value Of Financial Instruments *(Continued)*

The carrying amounts and estimated fair values of the Company's financial instruments are as follows

(dollars in thousands):

	December 31, 2006		December 31, 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 25,352	\$ 25,352	\$ 36,075	\$ 36,075
Interest-bearing deposits in banks	4,951	4,955	4,844	4,823
Investment securities	148,240	147,929	169,201	168,847
Loans and leases, net	382,993	382,630	365,571	364,589
FHLB stock	3,071	3,071	2,608	2,608
Accounts receivable servicing receivables	2,581	2,581	2,000	2,000
Accrued interest receivable	3,131	3,131	2,925	2,925
Cash surrender value of life insurance policies	9,697	9,697	5,073	5,073
Financial liabilities:				
Deposits	\$ 493,875	\$ 494,512	\$ 500,706	\$ 500,906
Short-term borrowings	37,270	37,270	39,386	39,386
Long-term borrowings	5,000	4,942	4,270	3,423
Accrued interest payable	868	868	795	795

**Note 20** Parent Only Condensed Financial Statements

## Condensed Balance Sheet

December 31, 2006 and 2005 (Dollars in thousands)

	2006	2005
Assets		
Cash and due from banks	\$ 308	\$ 316
Investment in subsidiaries	63,100	62,997
Dividends receivable from subsidiaries	300	842
Other assets	1,434	973
	<u>\$ 65,142</u>	<u>\$ 65,128</u>
Liabilities And Shareholders' Equity		
Liabilities:		
Dividends payable to shareholders	\$ 848	\$ 841
Other liabilities	1,923	1,541
Total liabilities	<u>2,771</u>	<u>2,382</u>
Shareholders' equity:		
Common stock	48,246	47,474
Retained earnings	14,690	16,029
Accumulated other comprehensive loss, net of taxes	(565)	(757)
Total shareholders' equity	<u>62,371</u>	<u>62,746</u>
	<u>\$ 65,142</u>	<u>\$ 65,128</u>

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Note 20** Parent Only Condensed Financial Statements (Continued)

## Condensed Statement Of Income

For the Years Ended December 31, 2006, 2005 and 2004 (Dollars in thousands)

	2006	2005	2004
Income:			
Dividends declared by subsidiaries – eliminated in consolidation	\$ 9,570	\$ 6,522	\$ 12,035
Management fee from subsidiaries – eliminated in consolidation	3,174	2,760	2,193
Other income	20	19	20
Total income	12,764	9,301	14,248
Expenses:			
Salaries and employee benefits	2,647	2,338	2,042
Professional fees	386	225	107
Directors' expense	237	339	433
Donations			503
Other expenses	726	611	524
Total expenses	3,996	3,513	3,609
Income before equity in undistributed income of subsidiaries	8,768	5,788	10,639
Equity in undistributed (distributed) income of subsidiaries	(28)	3,107	(5,355)
Income before income taxes	8,740	8,895	5,284
Income tax benefit	322	289	543
Net income	\$ 9,062	\$ 9,184	\$ 5,827

**Note 20** Parent Only Condensed Financial Statements (Continued)

## Consolidated Statement Of Cash Flows

For the Years Ended December 31, 2006, 2005 and 2004 (Dollars in thousands)

	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 9,062	\$ 9,184	\$ 5,827
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed (distributed) earnings of subsidiaries	28	(3,107)	5,355
Decrease (increase) in dividends receivable from subsidiaries	542	9,143	(9,635)
Stock option compensation expense	221		
(Increase) decrease in other assets	(206)	74	(149)
Increase (decrease) in other liabilities	32	(692)	1,149
Net cash provided by operating activities	9,679	14,602	2,547
Cash flows from investing activities:			
Cash paid to Bank of Amador shareholders		(12,730)	
Purchase of equipment	(58)	(353)	
Net cash used in investing activities	(58)	(13,083)	
Cash flows from financing activities:			
Cash dividends paid	(3,325)	(2,753)	(2,070)
Exercise of stock options, including tax benefit	441	945	1,959
Cash paid to repurchase common stock	(6,724)	(2,017)	(184)
Cash paid for fractional shares	(21)	(32)	
Net cash used in financing activities	(9,629)	(3,857)	(295)
Net (decrease) increase in cash and cash equivalents	(8)	(2,338)	2,252
Cash and cash equivalents at beginning of year	316	2,654	402
Cash and cash equivalents at end of year	\$ 308	\$ 316	\$ 2,654
Non-cash investing activities:			
Payable to Bank of Amador shareholders			\$ 12,730
Common stock issued in acquisition			\$ 18,284
Non-cash financing activities:			
Dividends declared and unpaid	\$ 848	\$ 841	\$ 582
Cumulative effect of adopting SAB 108, net of taxes	\$ 214		

American River Bankshares and Subsidiaries Notes to Consolidated Financial Statements (Continued)

**Karen Brown with Ray Byrne, President of North Coast Bank;  
Debbie Gesualdo, AVP & Senior Client Service Officer;  
Cindi Brown, VP & Business Development Officer;  
Laurie Todd-Dunlap, SVP & Loan Administrator**

**Steve Schofield, Business Development Officer; Nancy Melencheck,  
Loan Documentation Officer with Doug Tow, EVP & Chief Credit Officer;  
Zelda Casparis, VP & Central Support Services Manager with  
Kevin Bender, EVP & Chief Information Officer; and  
Anneliese Hein, VP & Human Resources Officer with David Taber, President & CEO.**

**Nanci Clarke, VP & Branch Manager;  
Theresa Bowers, Client Service Manager;  
Christina LaChapelle with Greg Patton, President of American River Bank;  
and Stephanie Minton, Financial Services Representative**

**Rosemarie Hatten, VP & Construction Loan Officer;  
Marsha Burney with Larry Standing, President of Bank of Amador;  
Cathy Williams, Client Services Manager and Trisha Ousby, AVP & Loan Officer**

**Colette Flannery, Central Support Services Lead; Anneliese Hein;  
Wendy Wells with Mitch Derenzo, EVP & CFO; and Zelda Casparis.**



